



COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 36 and 37

RIN 3038-AE94

Swap Execution Facility Requirements

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission (“Commission” or “CFTC”) is adopting final rules to amend certain parts of its regulations relating to the execution of package transactions on swap execution facilities (“SEFs”) and the resolution of error trades on SEFs. These matters are currently the subject of relief in certain no-action letters from Commission staff.

DATES: The rules will become effective [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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I. Background

A. Part 37 of the Commission’s Regulations

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) amended the Commodity Exchange Act (“CEA” or “Act”) by adding section 5h, which establishes registration requirements and core principles for swap execution facilities (“SEFs”).¹ The Commission implemented CEA section 5h by adopting regulations that establish various trading requirements for swaps traded on SEFs² and articulating, where appropriate, guidance and acceptable practices. In particular, the Commission promulgated part 37 of its regulations to implement section 5h of the CEA and set forth the registration and operational requirements for SEFs.³ Among those are

¹ 7 U.S.C. 7b-3.

² The Dodd-Frank Act also added to the CEA certain provisions related to the trading of swaps on designated contract markets (“DCMs”). Given that almost all platform trading of swaps in the U.S. occurs on SEFs, the Commission is not at this time amending any regulatory requirements pertaining to DCMs within part 38 of the Commission’s regulations.

³ Core Principles and Other Requirements for Swap Execution Facilities, 78 FR 33476 (June 4, 2013) (hereinafter “SEF Core Principles Final Rule”).

requirements in part 37 specifying minimum trading functionality that a SEF must offer to participants for all listed swaps, *i.e.*, an “order book,” as defined in § 37.3 (“Order Book”);⁴ specifying the types of systems or platforms that a SEF must offer for swaps trading, including swaps subject to the trade execution requirement under CEA section 2(h)(8);⁵ and setting forth other relevant regulations applicable to the fifteen core principles with which a SEF must comply to obtain and maintain registration with the Commission.

Commission regulation 37.9 prescribes the methods of execution that a SEF must offer to market participants to execute swap transactions on the SEF. In particular, § 37.9(a) defines “Required Transactions” as swaps subject to the trade execution requirement. Section 37.9(a) also requires a SEF to offer, as required methods of execution, either (i) an Order Book or (ii) a request-for-quote system that sends a request-for-quote to no less than three unaffiliated market participants and operates in conjunction with an Order Book (“RFQ System”) for the execution of these transactions.⁶ Swaps that are not subject to the trade execution requirement are defined as “Permitted Transactions,” for which a SEF may offer any execution method and for which market participants may voluntarily trade on a SEF.⁷ The Commission’s regulations specify additional requirements that correspond to the use of an Order Book or RFQ System to execute Required Transactions.⁸

⁴ 17 CFR 37.3(a)(2). An Order Book is defined as (i) an “electronic trading facility,” as that term is defined in CEA section 1a(16); (ii) a “trading facility,” as that term is defined in CEA section 1a(51); or (iii) a trading system or platform in which all market participants have the ability to enter multiple bids and offers, observe or receive bids and offers entered by other market participants, and transact on such bids and offers. *See* 17 CFR 37.3(a)(3).

⁵ CEA section 2(h)(8) requires that transactions involving swaps subject to the CEA section 2(h)(1) clearing requirement be executed on or pursuant to the rules of a DCM or SEF, or a SEF that is exempt from registration, unless no DCM or SEF makes such swaps available to trade (“MAT”) or such swaps qualify for the clearing exception under CEA section 2(h)(7) (the “trade execution requirement”). *See* 7 U.S.C. 2(h)(8).

⁶ 17 CFR 37.9(a). With the exception of block trades, as defined in § 43.2 of the Commission’s regulations, Required Transactions must be executed on a SEF’s Order Book or RFQ System. *See* 17 CFR 37.9(a)(2)(i).

⁷ 17 CFR 37.9(c).

⁸ For example, under § 37.9(b), the Commission implemented a fifteen-second time-delay requirement for Required Transactions that are pre-arranged or pre-negotiated by a broker and submitted as cross trades for

B. Summary of Proposed Changes to Parts 36 and 37

During the implementation of part 37, market participants and SEFs identified certain operational and compliance burdens related to various requirements. To mitigate these burdens, Commission staff issued to SEFs and market participants time-limited no-action relief from certain provisions of the CEA and the Commission's regulations.⁹ Based on this implementation experience, on February 19, 2020, the Commission released a proposal¹⁰ (the "Proposal") to amend the SEF regulatory framework to address the following issues, which had been identified in staff no-action letters. In particular, within the Proposal:¹¹

- The Commission proposed to amend part 37 to allow the swap components of certain categories of "package transactions"¹² to be executed on-SEF through flexible means of execution pursuant to § 37.9(c)(2), rather than through the required methods of execution under § 37.9(a) for "Required Transactions." In addition, the Commission proposed to amend part 36 to include an exemption from the trade execution requirement

execution through the SEF's Order Book. This requirement allows a broker or dealer to execute a Required Transaction by trading against a customer's order, or executing two customers' orders against each other, through pre-negotiation or pre-arrangement, provided that one side of the transaction is exposed to the Order Book for fifteen seconds before the other side of the transaction is submitted for execution. *See* 17 CFR 37.9(b).

⁹ As defined in § 140.99(a)(2) of the Commission's regulations, a no-action letter is a written statement issued by a Division stating that it will not recommend enforcement action to the Commission for failure to comply with a specific provision of the Act or a Commission rule, regulation, or order. A no-action letter represents only the issuing Division's position and binds only that Division. 17 CFR 140.99(a)(2).

¹⁰ *See* Swap Execution Facility Requirements and Real-Time Reporting Requirements, 85 FR 9407 (Feb. 19, 2020). The relief in many instances also applies to DCMs. *See supra* note 2.

¹¹ In addition to what is specified below, in the Proposal, the Commission proposed to amend the definition of "block trade" in § 43.2 to enable SEFs to offer non-Order Book methods of execution for market participants to execute swap block trades on the SEF. The proposed amendment would codify CFTC No-Action Letter No. 17-60 ("NAL No. 17-60") while also allowing block trades for swaps that are not intended to be cleared ("ITBC") to be executed on SEF via non-Order Book methods of execution. On September 17, 2020, the Commission adopted final rules amending certain regulations setting forth the real-time public swap reporting and dissemination requirements. Within those final rules, the Commission adopted, with minor technical changes, the Proposal's proposed amendment to the definition of "block trade" in § 43.2. Real-Time Public Reporting Requirements, 85 FR 75422 (Nov. 25, 2020) ("2020 Part 43 Final Rules").

¹² As used herein a package transaction consists of two or more component transactions executed between two or more counterparties where: (i) at least one component transaction is a Required Transaction; (ii) execution of each component transaction is contingent upon the execution of all other component transactions; and (iii) the component transactions are priced or quoted together as one economic transaction with simultaneous or near-simultaneous execution of all components.

for swap transactions that are executed as a component of a package transaction that also includes a component that is a new issuance bond (“New Issuance Bond package transactions”). CFTC No-Action Letter No. 20-31 (“NAL No. 20-31”),¹³ which extended and replaced NAL 17-55, currently provides no-action relief for the swap components of certain categories of package transactions from the required methods of execution, and in some instances, from the trade execution requirement.

- The Commission proposed to amend part 37 to establish a principles-based approach for SEF error trade policies that incorporated relief from the required methods of execution under § 37.9(a) for Required Transactions for trades intended to resolve error trades. The amendment would enable SEFs to permit market participants to execute swaps transactions to correct operational or clerical errors using execution methods other than those required under § 37.9(a) for Required Transactions. The Proposal did not seek

¹³ NAL No. 20-31, Re: Extension of No-Action Relief from Sections 2(h)(8) and 5(d)(9) of the Commodity Exchange Act and from Commission Regulations 37.3(a)(2) and 37.9 for Swaps Executed as Part of Certain Package Transactions (Oct. 9, 2020). NAL No. 20-31 extended no-action relief and related conditions previously granted by Commission staff. *See* CFTC Letter No. 14-12, No-Action Relief from the Commodity Exchange Act Sections 2(h)(8) and 5(d)(9) and from Commission Regulation § 37.9 for Swaps Executed as Part of a Package Transaction (Feb. 10, 2014) (“NAL No. 14-12”); CFTC Letter No. 14-62, No-Action Relief from the Commodity Exchange Act Sections 2(h)(8) and 5(d)(9) and from Commission Regulation § 37.9 for Swaps Executed as Part of Certain Package Transactions and No-Action Relief for Swap Execution Facilities from Compliance with Certain Requirements of Commission Regulations § 37.9(a)(2), § 37.203(a) and § 38.152 for Package Transactions (May 1, 2014) (“NAL No. 14-62”); CFTC Letter No. 14-121, Extension of No-Action Relief for Swap Execution Facilities and Designated Contract Markets from Compliance with Certain Requirements of Commission Regulations § 37.9(a)(2), § 37.203(a) and § 38.152 for Package Transactions (Sept. 30, 2014) (“NAL No. 14-121”); CFTC Letter No. 14-137, Extension of No-Action Relief from the Commodity Exchange Act Sections 2(h)(8) and 5(d)(9) and from Commission Regulation § 37.9 and Additional No-Action Relief for Swap Execution Facilities from Commission Regulation § 37.3(a)(2) for Swaps Executed as Part of Certain Package Transactions (Nov. 10, 2014) (“NAL No. 14-137”); CFTC Letter No. 15-55, Extension of No-Action Relief from the Commodity Exchange Act Sections 2(h)(8) and 5(d)(9) and from Commission Regulation § 37.9 and No-Action Relief for Swap Execution Facilities from Commission Regulation § 37.3(a)(2) for Swaps Executed as Part of Certain Package Transactions (Oct. 15, 2015) (“NAL No. 15-55”); CFTC Letter No. 16-76, Re: Extension of No-Action Relief from the Commodity Exchange Act Sections 2(h)(8) and 5(d)(9) and from Commission Regulation § 37.9 and No-Action Relief for Swap Execution Facilities from Commission Regulation § 37.3(a)(2) for Swaps Executed as Part of Certain Package Transactions (Nov. 1, 2016) (“NAL No. 16-76”); CFTC Letter No. 17-55, Re: Extension of No-Action Relief from Sections 2(h)(8) and 5(d)(9) of the Commodity Exchange Act and from Commission Regulations 37.3(a)(2) and 37.9 for Swaps Executed as Part of Certain Package Transactions (Oct. 31, 2017) (“NAL No. 17-55”). NAL No. 20-31 also provides relief for package transactions where at least one individual swap component is subject to the trade execution requirement and all other components are futures contracts (“MAT/Futures package transactions”). The Commission did not propose any regulations related to the MAT/Futures package transactions in the Proposal. As such, the Commission continues to evaluate MAT/Futures package transactions and their regulatory treatment. Further, NAL No. 20-31 also applies to package transactions occurring on a DCM. *See supra* note 2.

to codify the specific conditions contained in CFTC No-Action Letter No. 17-27 (“NAL No. 17-27”).¹⁴ Rather, the Proposal intended to capture the intent of NAL No. 17-27 to permit market participants to correct error trades in Required Transactions through non-required methods of execution while providing flexibility for SEFs to determine the most suitable error trade rules for their markets and participants.¹⁵

The Commission received six comment letters regarding the Proposal.¹⁶ After considering the comments, the Commission is adopting the rules as proposed. The Commission believes the rules adopted herein will decrease execution risks, improve efficiency, decrease transaction costs, promote operational efficiency, and lead to a more effective regulatory framework for SEFs.

¹⁴ The Proposal also did not propose to codify the supplemental conditions to NAL No. 17-27 contained in CFTC No-Action Letter No. 20-01, Re: Supplemental No-Action Relief for Swap Execution Facilities and Designated Contract Markets in Connection with Swaps with Operational or Clerical Errors Executed on a Swap Execution Facility or Designated Contract Market (Jan. 8, 2020) (“NAL No. 20-01”), conditions that allow market participants to correct error trades that have been accepted for clearing with an *ex post facto* review by the SEF. As discussed below, nothing in this adopting release would prohibit SEFs from incorporating such conditions within their error trade rules.

¹⁵ NAL No. 17-27, Re: No-Action Relief for Swap Execution Facilities and Designated Contract Markets in Connection with Swaps with Operational or Clerical Errors Executed on a Swap Execution Facility or Designated Contract Market (May 30, 2017). NAL No. 17-27 extended no-action relief and related conditions previously granted by Commission staff. *See* CFTC Letter No. 16-58, Re: No-Action Relief for Swap Execution Facilities and Designated Contract Markets in Connection with Swaps with Operational or Clerical Errors Executed on a Swap Execution Facility or Designated Contract Market (June 10, 2016) (“NAL No. 16-58”); CFTC Letter No. 15-24, Re: No-Action Relief for Swap Execution Facilities and Designated Contract Markets in Connection with Swaps with Operational or Clerical Errors Executed on a Swap Execution Facility or Designated Contract Market (Apr. 22, 2015) (“NAL No. 15-24”); and CFTC Letter No. 13-66, Time-Limited No-Action Relief for Swap Execution Facilities from Compliance with Certain Requirements of Commission Regulation 37.9(a)(2) and 37.203(a) (Oct. 25, 2013) (initial relief provided by Commission staff with respect to error trades that are rejected from clearing) (“NAL No. 13-66”). NAL No. 17-27 also applies to swap transactions occurring on a DCM. *See supra* note 2. In addition, DMO released NAL No. 20-01, which supplements the conditions in NAL No. 17-27 to allow market participants, *sua sponte*, to correct error trades that have been accepted to clearing with an *ex post facto* review by the SEF. NAL No. 20-01, Re: Supplemental No-Action Relief for Swap Execution Facilities and Designated Contract Markets in Connection with Swaps with Operational or Clerical Errors Executed on a Swap Execution Facility or Designated Contract Market (Jan. 8, 2020). Further, NAL 17-27 and NAL 20-01 also apply to operational or clerical errors occurring on a DCM. *See supra* note 2.

¹⁶ The following entities submitted comment letters: Citadel; The Futures Industry Association (“FIA”); IHS Markit (“Markit”); International Energy Credit Association (“IECA”); International Swaps and Derivatives Association, Inc. (“ISDA”); and ICAP Global Derivatives Limited (“IGDL”) and tpSEF, Inc. (“tpSEF”) (collectively the “TP ICAP SEFs”). In addition, the Commission received five letters from Better Markets; Carnegie Mellon; Chris Barnard; Foreign Exchange Professionals Association (“FXPA”); and Massachusetts Institute of Technology (“MIT”) that commented exclusively on proposals that were addressed in the 2020 Part 43 Final Rules. As such, they are not addressed further in this rulemaking. *See* 2020 Part 43 Final Rules.

C. Consultation with Other U.S. Financial Regulators

In adopting these rules, the Commission has consulted with the Securities and Exchange Commission, pursuant to section 712(a)(1) of the Dodd-Frank Act.¹⁷

II. Final Rules

A. Addition of § 37.9(d) and Amendment of § 37.9(a) for the Execution of Certain Package Transactions

1. Proposed Rules

Package transactions generally involve the execution of multiple component transactions together that market participants consider to represent one economic transaction.¹⁸ The types of transactions that constitute a package transaction are wide-ranging and diverse. In particular, there are package transactions that consist solely of swaps subject to the trade execution requirement; those that include a mix of swaps subject to the trade execution requirement and swaps that are not; those made up of swaps and non-swaps; and those comprised of both swaps that are and swaps that are not exclusively subject to the Commission's jurisdiction.¹⁹ These components range from being very liquid and standardized to being illiquid and bespoke.²⁰ The variety of package transactions derives, in part, from the fact that the different types of package transactions are fit for distinct purposes. The Commission understands that certain package transactions are utilized as tools within market participants' portfolio management and hedging programs, while other types of package transactions are used to

¹⁷ Dodd-Frank Act, Pub. L. No. 111-203, title VII, sec. 712(a)(1), 124 Stat. 1376 (2010).

¹⁸ See *supra* note 12. The Commission notes that there are transactions that otherwise meet the package transaction definition but do not involve a swap subject to the trade execution requirement. While these transactions may colloquially be referred to as package transactions, the Commission notes that such transactions are not the subject of these final rules.

¹⁹ See *infra* note 29 for a more precise description of various package transactions.

To the extent that counterparties may be facilitating package transactions that involve a "security," as defined in section 2(a)(1) of the Securities Act of 1933 or section 3(a)(10) of the Securities Exchange Act of 1934, or any component agreement, contract, or transaction over which the Commission does not have exclusive jurisdiction, the Commission does not opine on whether such activity complies with other applicable law and regulations.

²⁰ Some non-swap components may be subject to different regulatory requirements than the swap components in the package transactions.

allow market participants to express views of the market—for example, by allowing participants to trade the spread between certain products or different maturities in the same product.

Given the diverse characteristics of the component transactions that may be involved, the Commission understands that package transactions often pose unique pricing and execution characteristics. The Commission understands that the negotiation or arrangement of each of these components generally occurs concurrently or on a singular basis; in particular, negotiations for the pricing of such package transactions may be based primarily on the components that are not subject to the trade execution requirement. Further, given the individual liquidity and trading characteristics of each component, certain package transactions will have to trade through methods of execution that are suitable for an illiquid and bespoke component, which in many cases are not the required methods of execution.²¹

Notwithstanding the complexity of their pricing and execution, the Commission is aware of the benefits of such package transactions. By executing multiple components together as part of a package transaction, market participants can improve transaction pricing and cost, increase execution efficiency, and decrease execution risk beyond what would have been possible if the market participant had executed each component individually, *i.e.*, “legged” or “legging” into the transaction.²²

During the implementation of the trade execution requirement for certain interest rate swaps and credit default swaps, SEFs and market participants informed the Commission that requiring swaps that are otherwise Required Transactions—but are

²¹ For example, while a swap that is subject to the trade execution requirement is suitable to be executed through the required methods of execution as an outright transaction, when that same swap is bundled together with an illiquid and bespoke component in a package transaction, the package transaction takes on the liquidity and trading profile of the illiquid and bespoke component.

²² For example, a market participant seeking to execute two component transactions independent of one another, instead of executing the two components together in a package transaction, would be forced to pay the bid/offer spread on each leg, which in many cases is more costly and less efficient than paying the single bid/offer spread for a package transaction composed of the same two components.

components of a package transaction²³—to be executed through the required methods of execution²⁴ under § 37.9 was in many cases impracticable and increased execution risks and operational challenges. Market participants and SEFs informed the staff and the Commission that these risks and challenges generally reflect (i) an initial lack of market infrastructure available to trade and clear certain package transactions;²⁵ and (ii) the complex, bespoke, and idiosyncratic nature of several categories of package transactions that precluded them from being suitable for execution through required methods of execution.²⁶

Since the Division of Market Oversight’s (DMO’s) issuance of this no-action relief, the Commission has gained considerable knowledge and experience with the dynamics of the trading of package transactions, particularly with respect to the existing no-action relief from the required methods of execution. Based on this knowledge and experience, the Commission believed that certain aspects of the current requirements for the required methods of execution under § 37.9 should be enhanced to better account for the complex nature of the relevant package transactions.

As a result, in the Proposal the Commission proposed to add § 37.9(d) and amend § 37.9(a)(2) to permit the swap components of certain package transactions to be executed via flexible methods of execution pursuant to § 37.9(c)(2). The Commission proposed to define a “package transaction” as a transaction consisting of two or more component transactions executed between two or more counterparties where: (i) at least

²³ See *supra* note 12. Consistent with the definition of package transaction under § 37.9(d) the Commission notes that, unless otherwise stated, the term “swap component(s)” as used herein refers to a swap component that is subject to the trade execution requirement under CEA section 2h(8), and therefore a Required Transaction.

²⁴ As noted above, pursuant to § 37.9(a), SEFs must provide as the required methods of execution for Required Transactions either an Order Book or an RFQ System.

²⁵ See, e.g., NAL No. 14-12 at 2-3 n.10 (describing the inability of a derivatives clearing organization (“DCO”) to simultaneously screen and accept all components of a package transaction for clearing).

²⁶ See, e.g., CFTC Public Roundtable: Trade Execution Requirements and Package Transactions, 72, 84-85 (Feb. 12, 2014), available at <https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/transcript021214.pdf> (commenting on the challenges of applying required methods of execution to package transactions with complex component swaps).

one component transaction is a Required Transaction; (ii) execution of each component transaction is contingent upon the execution of all other component transactions; and (iii) the component transactions are priced or quoted together as one economic transaction with simultaneous or near-simultaneous execution of all components.²⁷ Based on this proposed definition and consistent with existing no-action relief, the Commission proposed to allow the Required Transaction swap component of the following three categories of package transactions to be executed via flexible means of execution pursuant to § 37.9(c)(2):

(1) A package transaction where at least one of the components is a swap exclusively within the Commission’s jurisdiction that is not subject to the clearing requirement (“MAT/Non-MAT Uncleared”);

(2) A package transaction where at least one of the components is not a swap (excluding certain package transaction categories as discussed below) (“MAT/Non-Swap Instrument”);²⁸ and

(3) A package transaction where at least one of the components is a swap for which the CFTC does not have exclusive jurisdiction, *e.g.*, a mixed swap (“MAT/Non-Exclusive CFTC Swap”).²⁹

²⁷ The Commission notes that there are transactions which otherwise meet the package transaction definition but do not involve a swap that is subject to the trade execution requirement. While these transactions may colloquially be referred to as package transactions, the Commission notes that such transactions are not the subject of these final rules. *See supra* note 12.

²⁸ Under § 37.9(d)(3), consistent with the no-action relief, this category specifically excludes package transactions in which all non-swap components are U.S. Treasury securities (“U.S. Dollar Spreadover package transactions”); MAT/Futures package transactions; package transactions in which all other non-swap components are agency mortgage-backed securities (“MAT/Agency MBS package transactions”); and New Issuance Bond package transactions. *See also* Section II.A.7 - Exemption of New Issuance Bond Package Transactions from the Trade Execution Requirement – Addition of § 36.1.

To the extent that counterparties may be facilitating package transactions that involve a “security,” as defined in section 2(a)(1) of the Securities Act of 1933 or section 3(a)(10) of the Securities Exchange Act of 1934, or any component agreement, contract, or transaction over which the Commission does not have exclusive jurisdiction, the Commission does not opine on whether such activity complies with other applicable law and regulations.

²⁹ The Commission notes that the swap components of different categories of package transactions have been subject to time-limited no-action relief provided by Commission staff from the trade execution requirement and required methods of execution. These categories of package transactions include those where: (i) each of the components is a swap subject to the trade execution requirement (“MAT/MAT package transactions”); (ii) at least one of the components is subject to the trade execution requirement and

2. Public Comment

Citadel, IHS Markit, IECA, ISDA, and the TP ICAP SEFs generally support the proposed addition of § 37.9(d) and amendment of § 37.9(a)(2) to permit the swap components of certain package transactions to be executed via flexible methods of execution pursuant to § 37.9(c)(2).³⁰

In particular, ISDA commends the Commission for codifying no-action relief, such as the package transaction relief, as it will “will reduce operational and compliance uncertainty, enhance efficiency, and improve regulatory oversight.”³¹

Citadel notes that the transition of package transactions from no-action relief to SEF trading has: (i) “improved pricing and liquidity as SEFs offer access to more competitive and transparent trading with a greater number of liquidity providers;” (ii) “enhanced market stability and integrity given the monitoring and surveillance

each of the other components is subject to the clearing requirement (“MAT/Non-MAT (Cleared)”); (iii) U.S. Dollar Spreadover package transactions; (iv) MAT/Agency MBS package transactions; (v) New Issuance Bond package transactions; (vi) MAT/Futures package transactions; (vii) MAT/Non-MAT (Uncleared); (viii) excluding aforementioned categories, MAT/Non-Swap Instruments; and (ix) MAT/Non-Exclusive CFTC Swap. *See* NAL No. 14-12; NAL No. 14-62; NAL No. 14-121; NAL No. 14-137; NAL No. 15-55; NAL No. 16-76; NAL No. 17-55; and NAL No. 20-31.

Subsequently, the swap components of the following categories of package transactions were no longer provided relief: MAT/MAT package transactions, MAT/Non-MAT (Cleared) package transactions, U.S. Dollar Spreadover package transactions, and MAT/Agency MBS package transactions. As a result, the swap components of these package transactions must be executed through the required methods of execution under § 37.9(a).

Currently, the swap components of the following categories of package transactions receive no-action relief from the required methods of execution under § 37.9 pursuant to NAL No. 20-31: (i) MAT/Non-MAT (Uncleared) package transactions; (ii) MAT/Non-Swap Instruments package transactions (subject to the exclusions previously discussed); and (iii) MAT/Non-Exclusive CFTC Swap package transactions. The addition of § 37.9(d) is consistent with the relief from the required methods of execution under NAL No. 20-31. Within section II, the term “relevant package transactions,” unless context requires otherwise, refers to these three categories of package transactions.

In addition to the relief from the required methods of execution in § 37.9(a), NAL No. 20-31 also provides relief from the trade execution for the swap components of MAT/Futures package transactions and New Issuance Bond Package transactions. As discussed above, the Commission is still evaluating MAT/Futures package transactions. *See supra* note 13.

Further, as discussed in more detail below, the Commission is exempting the swap components of New Issuance Bond package transactions from the trade execution requirement. This is consistent with the relief currently provided to New Issuance Bond package transactions under NAL No. 20-31. To the extent that counterparties may be facilitating package transactions that involve a “security,” as defined in section 2(a)(1) of the Securities Act of 1933 or section 3(a)(10) of the Securities Exchange Act of 1934, or any component agreement, contract, or transaction over which the Commission does not have exclusive jurisdiction, the Commission does not opine on whether such activity complies with other applicable law and regulations.

³⁰ Citadel at 1-2; IHS Markit at 8; IECA at 1-4; ISDA at 1; and TP ICAP SEFs at 1-3.

³¹ ISDA at 1.

capabilities of SEFs;” and (iii) “reduced operational risk through the pre-trade credit check and straight-through-processing requirements that are applicable to SEF trades.”³²

Citadel believes that such benefits would be threatened if the scope of package transactions eligible for flexible execution methods were expanded, such as altering block treatment for package transactions that have successfully transitioned onto SEFs.³³ However, Citadel supports codifying the remaining no-action relief for the “small number of categories” of package transactions as proposed in the Proposal.³⁴

The TP ICAP SEFs believe that the proposed rules for package transactions strike “an appropriate balance between the ‘utility of package transactions against the policy goals of the trade execution requirement’[.]”³⁵ The TP ICAP SEFs support the increased flexibility for execution methods for swap components of the relevant package transactions “to be executed on-SEF through flexible means of execution pursuant to proposed Rule 37.9(c)(2), rather than through the required methods of execution under Commission Rule 37.9....”³⁶ The TP ICAP SEFs support allowing SEF trades to be executed through any means of interstate commerce.³⁷ As such, the TP ICAP SEFs believe that Proposal for package transactions brought the SEF “regime closer to the flexible framework envisioned by Congress in 2010, and will assist in the liquidity formation and trade execution of package transactions, further promoting the trading of swaps on SEFs.”³⁸

Similarly, IECA supports flexible methods of execution for package transactions.³⁹ IECA believes that allowing flexible methods of execution for package transactions “will encourage SEFs to develop new and innovative trade execution

³² Citadel at 1-2.

³³ *Id.* at 2.

³⁴ *Id.*

³⁵ TP ICAP SEFs at 2.

³⁶ *Id.*

³⁷ *Id.* at 3.

³⁸ *Id.*

³⁹ IECA at 4.

methods” for package transactions and the development of new and innovative execution methods may result in commercial end-users and their hedging affiliates executing more transactions on SEFs.⁴⁰

The Commission received two comments regarding MAT/Future package transactions. Citadel recommends that the Commission work to bring MAT/Futures package transactions onto SEFs to bring “greater price transparency to market participants.”⁴¹ However, ISDA recommends that MAT/Futures package transactions be exempted from the Trade Execution Requirement.⁴²

The Commission received one comment, from IECA, requesting that the Commission clarify that § 37.203(a)’s prohibition of pre-arranged trading does not apply to package transactions.⁴³

ISDA requested that the Commission reevaluate the process for determining the scope of the trade execution (“MAT Process”) requirement in order to permit SEFs and market participants “to modify the scope of contracts subject to the trade execution requirement, which is particularly important during times of increased market stress.”⁴⁴

Finally, the TP ICAP SEFs requested that the Commission adopt other Commission staff no-action letters not included in the Proposal.⁴⁵

3. Commission Determination

The Commission is adopting the addition of § 37.9(d) and amendment of § 37.9(a)(2) to permit the swap components of certain package transactions to be executed via flexible methods of execution pursuant to § 37.9(c)(2) as proposed and as was

⁴⁰ *Id.*

⁴¹ Citadel at 2.

⁴² ISDA at 1-2.

⁴³ IECA at 5. Further, IECA requested clarification that uncleared bilateral swaps that are permitted transactions, in particular such swaps that include a counterparty that has elected the end-user or affiliate exceptions under CEA section 2(h)(7), “are exempt from the prohibition against pre-arranged trading.” *See* IECA at 7. The Commission did not propose any changes to the pre-arranged trading prohibition in § 37.203(a) in the Proposal. Accordingly, § 37.203(a) continues to apply, as applicable, to such transactions.

⁴⁴ ISDA at 2.

⁴⁵ TP ICAP SEFs at 4-5.

supported by commenters.⁴⁶ While, as noted above and commented on by Citadel, the swap components of several types of package transactions have been successfully transitioned to SEFs and are executed via the required methods of execution, the Commission believes, and agrees with IHS Markit, that the types of package transactions covered by this final rulemaking are not suitable to be traded through the required methods of execution due to their specific characteristics.⁴⁷ In particular, the Commission recognizes that these package transactions contain components that are illiquid and bespoke, such as swaptions, or contain components that are subject to regulatory requirements other than or in addition to the CEA and the Commission's regulations issued thereunder.⁴⁸

The Commission believes that if market participants are unable to utilize flexible methods of execution for the swap components of these package transactions, they would potentially be forced to break the package transaction into its individual components, otherwise known as "legging" into the transaction. The Commission understands from market participants that legging into a package transaction is inefficient and increases transaction costs and execution risks. Given that components of package transactions are each priced or quoted together as part of one economic transaction, the Commission recognizes the impracticality of breaking the package transaction into individual legs or components in order to trade the swap components via the required methods of execution under § 37.9(a).

⁴⁶ Citadel at 1-2; IHS Markit at 8; IECA at 1-4; ISDA at 1; and TP ICAP SEFs at 1-3. The Commission is also re-designating existing § 37.9(d) to § 37.9(f) in order to keep the rules setting forth permissible execution methods in § 37.9 grouped together. In conjunction with re-designating existing § 37.9(d) to § 37.9(f), the Commission is making ministerial edits to correct internal cross references in re-designated § 37.9(f).

⁴⁷ See IHS Markit at 8.

⁴⁸ The Commission will continue to evaluate these categories of package transactions for new developments in execution methods on SEFs and may in the future revise the categories of package transactions in which the swap component is eligible to be executed through flexible means of execution.

Based on its experience with the existing no-action relief and supported by commenters, the Commission believes that the addition of § 37.9(d) and amendment of § 37.9(a) will allow market participants to choose the most suitable execution method for their package transactions, which will decrease execution risks, improve efficiency, and decrease transaction costs because market participants will no longer be forced to leg into transactions.⁴⁹ Given the inherent complexity of the relevant package transactions, the Commission believes that this final rule ensures that market participants are able to trade these package transactions in the most effective, efficient, transparent, and economical manner. As a result of this final rulemaking, SEFs will be able to offer, and market participants would be able to utilize, methods of execution that best suit the characteristics of the relevant package transaction being traded. The Commission believes this will help preserve the benefits and purpose of executing such package transactions.

In addition to causing inefficient execution and increasing risks and cost, forcing the swap components of the relevant package transactions through required methods of execution may also limit the commercial utility of such transactions or entirely frustrate the purposes of entering in such package transactions in the first place. For example, the Commission understands that in some of the relevant package transactions, (i) the swap component serves as the hedging instrument to other instruments in the package transaction, or (ii) the package transaction as a whole may be utilized as part of a market participant's portfolio management program. If the swap component of such package transactions were impractical or unable to be executed due to the required methods of execution, market participants would be prevented from entering or effectively entering into the package transaction, nullifying the package transaction's purpose and benefits as a hedging and portfolio management tool. Based on its experience with the existing no-

⁴⁹ See ISDA at 1, TP ICAP SEFs 2-3, and IECA 4.

action relief, the Commission believes that these final rules will allow market participants to utilize flexible methods of execution for the swap component of the relevant package transaction, thereby ensuring that market participants are able to continue to utilize these effective hedging tools.

Further, the Commission agrees with the TP ICAP SEFs that these final rules will advance the SEF statutory goal of promoting trading on SEFs.⁵⁰ These final rules provide relief from execution method requirements that are generally intended to help promote trading on SEFs.⁵¹ However, the swap components of the relevant package transactions are not suitable for trading via such required methods of execution, as discussed above. Accordingly, the Commission believes that in this case flexibility with respect to execution methods will better promote trading of such component swaps on SEFs, consistent with the statutory SEF goals. In addition, the Commission agrees with IECA that flexible methods of execution for the swap components of the package transactions in these final rules may encourage SEFs to develop new and innovative methods of executions.⁵²

⁵⁰ See TP ICAP SEFs at 3. See also 7 U.S.C. 7b-3(e).

⁵¹ Further, while the final rules also provide flexibility from the required methods of execution that are otherwise intended to help promote pre-trade transparency on SEFs, the Commission notes that permitting market participants to use flexible methods of execution is consistent with how package transactions are treated within other jurisdictions. For example, in the European Union (“EU”), certain package transactions (including package transactions for which the Commission currently requires the swap component to be executed through the required methods of execution, such as U.S. Dollar Spreadover package transactions) are eligible to be waived from the EU’s transparency regime. The Commission believes that these final rules strike an appropriate balance between promoting pre-trade transparency and ensuring that U.S. markets and their participants are not unnecessarily burdened. See Regulation (EU) 2016/1033 of the European Parliament and of the Council of 23 June 2016 amending Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) No 596/2014 on market abuse and Regulation (EU) No 909/2014 on improving securities settlement in the European Union and on central securities depositories, Commission Delegated Regulation (EU) 2017/2194 of 14 August 2017 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to package orders, and Commission Delegated Regulation (EU) 2017/583 of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives. The Commission further believes that in this regard, these final rules further the establishment of consistent international standards with respect to the regulation of swaps as directed by Congress in the Dodd-Frank Act. See Section 752(a) of the Dodd-Frank Act, *supra*.

⁵² See IECA at 4.

The Commission agrees with Citadel that the transition of the swap components of package transactions from no-action relief to SEF trading has: (i) improved pricing and liquidity as SEFs offer access to more competitive and transparent trading with a greater number of liquidity providers; (ii) enhanced market stability and integrity given the monitoring and surveillance capabilities of SEFs; and (iii) reduced operational risk through the pre-trade credit check and straight-through-processing requirements that are applicable to SEF trades.⁵³ Therefore, the Commission agrees with Citadel that the swap components of package transactions not currently subject to existing no-action relief should continue to be subject to the required methods of executions under § 37.9(a).⁵⁴

In response to Citadel and ISDA's comments regarding MAT/Futures, as noted above, the Commission notes that it did not propose any regulations related to MAT/Futures package transactions and is continuing to evaluate the regulatory treatment of MAT/Futures package transactions. Therefore, the Commission declines to adopt any regulations related to MAT/Futures package transactions in this release.⁵⁵

IECA asked the Commission to clarify that package transactions are not subject to the pre-arranged trading ban in § 37.203(a).⁵⁶ The Commission did not propose to change any requirements related to pre-arranged trading in the Proposal. However, the Commission makes clear that the requirements in § 37.203(a) apply to the swap components of package transactions. While not suitable for swap components of package transactions that have successfully transitioned onto SEF,⁵⁷ the Commission does note that for swap components of package transactions subject to this final rule – MAT/Non-

⁵³ See Citadel at 1-2.

⁵⁴ See *id.* In response to Citadel's comment that the scope of package transactions eligible to be executed through flexible methods of execution should not be expanded, such as altering the treatment of block package transactions, the Commission notes that it did not propose any changes related to the treatment of block package transactions. Therefore, the Commission is taking no action related to the treatment of block package transactions in these final rules.

⁵⁵ The Commission notes the MAT/Futures package transactions continue to fall within the bounds of current Commission staff relief provided in NAL No. 20-31 for MAT/Futures package transactions.

⁵⁶ See IECA at 5.

⁵⁷ However, such swap components of package transactions may still be executed subject to the requirements of § 37.9(b)(1). 17 CFR 37.9(b)(1).

MAT Uncleared, MAT/Non-Swap Instrument, and MAT/Non-Exclusive CFTC Swap – the existing pre-arranged trading prohibition already provides an exception by allowing a SEF to adopt trading practices that are certified or approved by the Commission pursuant to part 40 of the Commission’s regulations.⁵⁸ Accordingly, the Commission anticipates that a SEF would implement final § 37.9(d) by self-certifying or adopting rules subject to Commission review under part 40 that specify the manner in which counterparties may execute the swap components of MAT/Non-MAT Uncleared, MAT/Non-Swap Instrument, and MAT/Non-Exclusive CFTC Swap package transactions.

The Commission acknowledges ISDA’s comment regarding amending the MAT Process to allow modification of the swaps that are subject to the trade execution requirement, especially during times of market stress.⁵⁹ However, the Commission did not propose any amendments to the MAT Process in the Proposal. Further, the Commission believes that such a substantive change should be subject to notice and comment rulemaking. Therefore, the Commission declines to adopt ISDA’s suggested amendment to the MAT process at this time.

Further, the Commission acknowledges the TP ICAP SEFs’ request that the Commission evaluate adopting additional no-action relief that was not proposed to be codified in the Proposal.⁶⁰ The Commission will evaluate whether there is additional no-action relief that is currently outstanding that should be codified but declines to codify at this time without further notice and comment any no-action relief that was not proposed to be codified in the Proposal.

Therefore, for the reasons stated above, the Commission is adopting the addition of § 37.9(d) and amendment of § 37.9(a)(2) to permit the swap components of certain

⁵⁸ See 17 CFR 37.203(a).

⁵⁹ ISDA at 1-2.

⁶⁰ See TP ICAP SEFs at 4-5.

package transactions to be executed via flexible methods of execution pursuant to § 37.9(c)(2) as proposed.⁶¹

B. Addition of § 37.3(a)(4)

1. Proposed Rule

In the Proposal, the Commission proposed to add § 37.3(a)(4) to allow SEFs not to offer an Order Book for the swap components of the following package transactions:

(i) MAT/Non-MAT Uncleared package transactions; (ii) MAT/Non-Swap Instrument package transactions; and (iii) MAT/Non-Exclusive CFTC Swap package transactions.⁶²

An Order Book is one of the two required methods of execution under § 37.9(a). The Commission designated an Order Book as the “minimum trading functionality” each SEF must maintain and offer for each swap that it lists for trading. An Order Book is defined under § 37.3(a)(3) as (i) an electronic trading facility;⁶³ (ii) a trading facility;⁶⁴ or (iii) a trading system or platform in which all market participants in the trading system or platform have the ability to enter multiple bids and offers, observe or receive bids and offers entered by other market participants, and transact on such bids and offers.⁶⁵

Generally speaking, it may be complex to apply the existing Order Book requirement in § 37.3(a)(2) to the swap components of the package transactions covered

⁶¹ The Commission notes that upon the effective date of these rules, the addition of § 37.9(d) and amendment of § 37.9(a)(2), as well as the adoption of § 37.3(a)(4) as discussed below, will negate the need for the relief provided in NAL No. 20-31 for MAT/Non-MAT Uncleared, MAT/Non-Swap Instrument, and MAT/Non-Exclusive CFTC Swap package transactions.

⁶² However, the Proposal did not alter any requirement applicable to such swap components to the extent they are executed in transactions that were not package transactions covered by the Proposal. The text of proposed § 37.3(a)(4) made clear that § 37.3(a)(2) of the Commission’s regulations would continue to apply to such swap components and SEFs would be required to offer Order Books for these Required Transactions as outright transactions.

⁶³ CEA section 1a(16) defines “electronic trading facility” as a trading facility that (i) operates by means of an electronic or telecommunications network; and (ii) maintains an automated audit trail of bids, offers, and the matching of orders or the execution of transactions on the facility. 7 U.S.C. 1a(16).

⁶⁴ CEA section 1a(51) defines “trading facility” as “a person or group of persons that constitutes, maintains, or provides a physical or electronic facility or system in which multiple participants have the ability to execute or trade agreements, contracts, or transactions (i) by accepting bids or offers made by other participants that are open to multiple participants in the facility or system; or (ii) through the interaction of multiple bids or multiple offers within a system with a pre-determined non-discretionary automated trade matching and execution algorithm.” 7 U.S.C. 1a(51)(A).

⁶⁵ 17 CFR 37.3(a)(3).

by this proposed amendment. In some situations, § 37.3(a)(2) may require that a SEF maintain separate Order Books for the same type of swap: one Order Book for when the swap is executed as a single transaction (referred to as an “outright transaction”), and a separate Order Book for when the swap is executed as part of a package transaction. In fact, multiple Order Books could be required for the same type of swap if it were included as part of multiple types of package transactions. The Commission understands that, in part because of the availability of relief under the staff letters described above, SEFs have put in place relatively few Order Books for swaps to be executed as part of the package transactions covered by the Proposal, and any such Order Books in place are not actively used.

2. Public Comment

Citadel, IECA, ISDA, and the TP ICAP SEFs generally support the codification of existing relief for package transactions which includes relief from having to provide an Order Book for (i) MAT/Non-MAT Uncleared package transactions; (ii) MAT/Non-Swap Instrument package transactions; and (iii) MAT/Non-Exclusive CFTC Swap package transactions.⁶⁶

3. Commission Determination

The Commission agrees with commenters and is adopting § 37.3(a)(4) as proposed to allow SEFs not to offer an Order Book for the swap components of the following package transactions: (i) MAT/Non-MAT Uncleared package transactions; (ii) MAT/Non-Swap Instrument package transactions; and (iii) MAT/Non-Exclusive CFTC

⁶⁶ See Citadel at 1-2; IHS Markit at 8; IECA at 2-4; ISDA at 1; and TP ICAP SEFs at 1-3. The TP ICAP SEFs based part of their support on the idea that Permitted Transactions “[do] not require an Order Book under the Commission’s regulations.” TP ICAP SEFs at 3. Out of an abundance of caution, the Commission notes that while Permitted Transactions are not required to be executed through Order Books or RFQ Systems, as part of the § 37.9(a)’s required methods of execution, SEF’s are still required to provide Order Books for permitted transactions as part of the minimum trading functionality requirements in § 37.3(a)(2).

Swap package transactions.⁶⁷ As noted above,⁶⁸ executing Required Transaction swap components of certain package transactions through the required methods of execution is operationally complex, and in many instances, impracticable. Given that the Commission continues to believe that it is infeasible or inefficient to facilitate swap components of these package transactions through the required methods of execution, which includes an Order Book under § 37.3(a), it logically follows that requiring SEFs to offer an Order Book for the swap components of package transactions would be superfluous.

Finally, the Commission believes that not requiring SEFs to offer an Order Book for the swap components of the relevant package transactions would help reduce operating costs for SEFs, as they would no longer be required to operate and maintain order book systems that are not suitable for trading the swap components of the relevant package transactions. Instead of employing resources to build (or attempt to build) and support an unused or underutilized Order Book for the swap components of certain package transactions, the final rules will instead provide a SEF with the flexibility to determine how to allocate its resources, particularly as it relates to developing methods of execution that are better suited to trading the relevant package transactions.⁶⁹

Therefore, for the reasons stated above, the Commission is adopting § 37.3(a)(4) as proposed to allow SEFs not to offer an Order Book for the swap components of the following package transactions: (i) MAT/Non-MAT Uncleared package transactions; (ii) MAT/Non-Swap Instrument package transactions; and (iii) MAT/Non-Exclusive CFTC Swap package transactions.⁷⁰

⁶⁷ However, these final rules do not alter any requirement applicable to such swap components to the extent they are executed in transactions that are not package transactions covered by this amendment. The text of § 37.3(a)(4) makes clear that § 37.3(a)(2) of the Commission's regulations continues to apply to such swap components and SEFs would be required to offer Order Books for these Required Transactions as outright transactions.

⁶⁸ See section II.A. – Addition of § 37.9(d) and Amendment of § 37.9(a) for the Execution of Certain Package Transactions.

⁶⁹ The Commission notes that nothing in these final rules would preclude a SEF from offering an Order Book if it is able to develop an Order Book solution that is effective in trading the swap component of the relevant package transactions.

⁷⁰ See *supra* note 61.

C. Exemption of New Issuance Bond Package Transactions from the Trade

Execution Requirement – Addition of § 36.1

1. Proposed Exemption

In the Proposal, the Commission proposed new rules under part 36 of the Commission’s regulations to establish an exemption to the trade execution requirement for swap transactions that are components of a “New Issuance Bond” package transaction. The Commission believes that exempting these types of transactions from the trade execution requirement is authorized by, and would be consistent with the objectives of, CEA section 4(c).⁷¹ The Proposal was consistent with the time-limited no-action relief provided by Commission staff for this category of package transactions.⁷²

New Issuance Bond package transactions include at least one individual swap component that is subject to the trade execution requirement and at least one individual component that is a bond issued and sold in the primary market.⁷³ An underwriter (on behalf of an issuer) arranges the issuance of a bond packaged with a fixed-to-floating interest rate swap (“IRS”) that features the issuer as a counterparty. The terms of the IRS, which include tenor and payment terms, typically match the terms of the bond issuance. By issuing a bond with a fixed-to-floating IRS, issuers are able to effectively turn fixed-rate liabilities into variable-rate liabilities, or vice versa.⁷⁴ To match the terms between these two components and facilitate the bond issuance in an efficient and cost-effective

⁷¹ 7 U.S.C. 6(c).

⁷² See *supra* note 29 (describing the no-action relief from the trade execution requirement provided by Commission staff for categories of package transactions).

⁷³ The Commission understands that a bond issued and sold in the primary market that may constitute part of a package transaction is a “security,” as defined in section 2(a)(1) of the Securities Act of 1933 or section 3(a)(10) of the Securities Exchange Act of 1934. To the extent that counterparties may be facilitating package transactions that involve a security, or any component agreement, contract, or transaction over which the Commission does not have exclusive jurisdiction, the Commission does not opine on whether such activity complies with other applicable law and regulations.

⁷⁴ For example, a bond issuer seeks to pay variable rates on its bonds, but prospective investors may seek a fixed rate of return. By arranging a New Issuance Bond package transaction, the bond issuer can issue a fixed-rate bond and simultaneously enter into an offsetting IRS. The IRS enables the issuer to receive a fixed rate that matches the fixed rate on its bond to be issued, while paying the variable rate that it originally sought. Ultimately, this arrangement may allow the bond issuer to issue the fixed-rate bond at a lower cost.

manner, the IRS component is customized and negotiated in a manner that closely corresponds to the bond issuance process.

Given the process under which the swap is negotiated,⁷⁵ this type of package transaction has not been conducive to execution on a SEF trading system or platform. The Commission notes that the no-action relief that has been provided by Commission staff for these swaps components reflects the ongoing lack of an available execution method on an appropriate trading venue.⁷⁶ Based on the integral role of the bond issuance in facilitating the component swap execution, the Commission believes that the IRS component is not suitable for execution on a SEF, even if a SEF were able to offer flexible means of execution, as the Commission proposed for swap components of other package transactions in the Proposal.⁷⁷

Therefore, consistent with current no-action relief provided by Commission staff, the Commission proposed to exempt swap components of a New Issuance Bond package transaction from the trade execution requirement within new § 36.1. The proposed exemption would establish that a “package transaction” consists of two or more component transactions executed between two or more counterparties, where (i) at least one component transaction is subject to the trade execution requirement in section 2(h)(8) of the Act; (ii) execution of each component transaction is contingent upon the execution of all other component transactions; and (iii) the component transactions are priced or quoted together as one economic transaction with simultaneous or near-simultaneous execution of all components.⁷⁸

2. Public Comment

⁷⁵ The Commission notes that these types of package transactions differ from other package transactions that involve the purchase or sale of a security in the secondary market, given that they involve the issuance of a new security.

⁷⁶ See NAL No. 20-31 at 2-3.

⁷⁷ See Section II.A.2.

⁷⁸ The Commission notes that this definition is consistent with the definition for package transaction in § 37.9(d)(1).

Citadel, IECA, ISDA, and the TP ICAP SEFs generally support the codification of existing relief for package transactions which includes relief from the trade execution requirement for the swap components of New Issuance Bond package transactions.⁷⁹

In addition, as noted above, ISDA recommends that MAT/Futures package transactions be exempted from the Trade Execution Requirement.⁸⁰

3. Commission Determination and Discussion of CEA Section 4(c) Authority

Section 4(c) of the CEA grants the Commission the authority to exempt any transaction or class of transactions, including swaps, from certain provisions of the CEA, including the Commission's trade execution requirement, in order to "promote responsible economic or financial innovation and fair competition."⁸¹ Section 4(c)(2) of the CEA further provides that the Commission may not grant exemptive relief unless it determines that: (i) the exemption is appropriate for the transaction and consistent with the public interest; (ii) the exemption is consistent with the purposes of the CEA; (iii) the transaction will be entered into solely between "appropriate persons;" and (iv) the exemption will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory responsibilities under the CEA. In enacting section 4(c), Congress noted that the purpose of the provision is to give the Commission a means of providing certainty and stability to existing and emerging markets so that financial innovation and market development can proceed in an effective and competitive manner.⁸²

The Commission believes that exempting swap components of New Issuance Bond package transactions from the trade execution requirement is consistent with the objectives of CEA section 4(c).⁸³ The Commission recognizes the inherent challenges in

⁷⁹ See Citadel at 1-2; IHS Markit at 8; IECA at 2-4; ISDA at 1; and TP ICAP SEFs at 1-3.

⁸⁰ ISDA at 1-2.

⁸¹ 7 U.S.C 6(c); *see also* 7 U.S.C. 2(d).

⁸² House Conf. Report No. 102-978, 1992 U.S.C.C.A.N. 3179, 3213.

⁸³ The Commission notes that this exemption would not apply to swap components of package transactions that include sovereign debt, such as U.S. Treasury bonds, notes, and bills.

trading or executing these swap components on a SEF or DCM and, therefore, recognizes the benefits of continuing to allow market participants to maintain established market practices with respect to this type of package transaction.

The Commission recognizes the importance of new bond issuances in helping market participants to raise capital and fund origination loans for businesses and homeowners. The Commission recognizes that allowing the swap components of New Issuance Bond package transactions to be executed away from a SEF or DCM—consistent with current market practice—is integral to facilitating the bond issuance. Further, the Commission recognizes that the exemption is limited in nature, *i.e.*, the swap transaction remains subject to all other applicable Commission rules and regulations.

Therefore, the Commission believes that the exemption from the trade execution requirement for swap components of New Issuance Bond package transactions is appropriate and would be consistent with the public interest and purposes of the CEA.

The Commission further believes that the regulation would not have a material adverse effect on the ability of the Commission or any SEF or DCM to discharge its regulatory or self-regulatory duties under the CEA. The Commission notes that the exemption is limited in scope and the swap components subject to this exemption are still required to be reported to a swap data repository pursuant to parts 43 and 45 of the Commission’s regulations. Further, the Commission retains its special call, anti-fraud, and anti-evasion authorities, which will enable it to adequately discharge its regulatory responsibilities under the CEA.

The Commission notes that under the exemption, swap transactions would still be entered into solely between eligible contract participants (“ECPs”), whom the Commission determines, for purposes of this exemption, to be appropriate persons within the scope of section 4(c)(3)(K) of the CEA.⁸⁴ This determination is consistent with, and

⁸⁴ 7 U.S.C. 6(c)(3)(K).

rests on the same reasoning of, previous Commission determinations that ECPs are appropriate persons.⁸⁵ As the Commission has noted, the elements of the ECP definition (as set forth in section 1a(18)(A) of the CEA and Commission regulation 1.3) generally are more restrictive than the comparable elements of the enumerated “appropriate person” definition.⁸⁶ Given that only ECPs are permitted to enter into swaps off of a DCM, there is no risk that a non-ECP or a person who does not satisfy the requirements for an “appropriate person” could enter into a New Issuance Bond package transaction using this exemption. Therefore, the Commission believes that the class of persons eligible to rely on the exemption for New Bond Issuance package transactions will be limited to “appropriate persons” within the scope of section 4(c)(3) of the CEA.

For the reasons stated above, the Commission is finalizing the exemption from the trade execution requirement for New Issuance Bond package transactions with the addition of new § 36.1.⁸⁷ In response to ISDA’s comment regarding MAT/Futures, as noted above, the Commission notes that it did not propose any regulations related to MAT/Futures package transactions and is continuing to evaluate the regulatory treatment of MAT/Futures package transactions. As such, the Commission declines to adopt any regulations related to MAT/Futures package transactions in this release.

D. Error Trades: Execution of Trades to Correct Operational and Clerical Errors on Swap Execution Facilities – Addition of § 37.9(e)

1. Proposed Rules

In the Proposal, the Commission proposed to amend the SEF regulatory framework by adding subsection (e) to § 37.9 to establish a flexible SEF error trade policy standard that would, among other things, incorporate the intent of the existing no-

⁸⁵ See, e.g., Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21750, 21754 (Apr. 11, 2013).

⁸⁶ *Id.*

⁸⁷ The Commission notes that upon the effective date of these rules, exemption from the trade execution requirement for swap components of New Issuance Bond package transactions will negate the need for the relief provided in NAL No. 20-31 for New Issuance Bond package transactions.

action relief in NAL No. 17-27 and NAL No. 20-01 for resolving errors in Required Transactions. Proposed § 37.9(e)(2)(i) requires that a SEF must maintain rules and procedures that are fair, transparent, consistent, and allow for timely resolution of an “error trade,” as defined under proposed § 37.9(e)(1)(ii).⁸⁸ The error trade rules in the Proposal would apply to any error trade that occurs on a SEF, regardless of whether the swap is submitted for clearing or not.

Further, proposed § 37.9(e)(2)(i) would require SEFs to have error trade rules and procedures that require market participants to provide prompt notice to the SEF of an error trade and, as applicable, the corresponding correcting trade and offsetting trade. The Proposal made clear that this notice need not be separate from the error trade correction process.

In the Proposal, for correcting trades associated with an error trade that has been rejected from clearing, proposed § 37.9(e)(2)(i)(A) would require the SEF to submit the correcting trade for clearing to the registered DCO or exempt DCO as soon as technologically practicable, but no later than one hour after notice of the rejection to the relevant clearing members. For an offsetting trade and a correcting trade associated with an error trade that already has been accepted for clearing, proposed § 37.9(e)(2)(i)(B) would require the SEF to submit both types of trades to the registered DCO or exempt DCO as soon as technologically practicable, but no later than three days after the registered DCO or exempt DCO accepted the error trade for clearing. In addition to these proposed timeframes, proposed § 37.9(e)(2)(ii) would prohibit counterparties from executing a second correcting trade to fix an error trade if the initial correcting trade is rejected from clearing.

2. Public Comment

⁸⁸ As proposed, an “error trade” would be defined as any trade executed on or subject to the rules of a swap execution facility that contains an operational or clerical error.

Citadel, IHS Markit, IECA, ISDA, and the TP ICAP SEFs generally supported the Proposal to establish a flexible SEF error trade policy standard in § 37.9(e).⁸⁹

In particular, ISDA commended the Commission for codifying no-action relief, such as the relief granted for error trades, as it “will reduce operational and compliance uncertainty, enhance efficiency, and improve regulatory oversight.”⁹⁰

Citadel stated that it supports “the Proposal’s formal codification of the remaining no-action relief that allows ... the efficient resolution of error trades on SEFs.”⁹¹ In particular, Citadel supports the codification of the existing error trade no-action relief “which enables SEFs and market participants to efficiently correct transactions that have an operational or clerical error. This includes permitting SEFs to allow members to quickly correct an error trade on their own, with an *ex post facto* review performed by the SEF.”⁹² Further, Citadel believes it is important that “error trade cancellations and corrected trades be properly reported pursuant to Parts 43 and 45” and recommends that the Commission address the reporting of error trades in the final rules.⁹³

The TP ICAP SEFs support the Proposal as it would “establish a principles-based approach for SEF error trade policies that incorporates relief from the required methods of execution under proposed Rule 37.9 for Required Transactions for trades intended to resolve error trades.”⁹⁴ The TP ICAP SEFs believe the principles-based approach provides “flexibility for SEFs to determine the most suitable error trade rules for their markets and participants.”⁹⁵ Further, the TP ICAPs SEFs believe that the Proposal’s approach in providing flexibility that is consistent with the SEF core principles “is an appropriate approach to implementing the related statutory provision with the regulatory

⁸⁹ Citadel at 1-2; IHS Markit at 8; IECA at 2; ISDA at 1; and TP ICAP SEFs at 1-4.

⁹⁰ ISDA at 1.

⁹¹ Citadel at 1.

⁹² *Id.* at 2.

⁹³ *Id.* at 3.

⁹⁴ TP ICAP SEFs at 3.

⁹⁵ *Id.*

certainty of a Commission rule, while preserving discretion for SEFs to formulate the specific approach most appropriate for their customers.”⁹⁶

In addition, on the basis that SEF participants are sophisticated institutions, the TP ICAP SEFs support the proposed requirements in § 37.9(e)(2)(i) “that SEFs must have error trade rules and procedures that require market participants to provide prompt notice to the SEF of an error trade and, as applicable, the corresponding correcting trade and offsetting trade.”⁹⁷

While IHS Markit commends the Commission for codifying the error-trade no-action relief in the Proposal, IHS Markit recommended that, especially during periods of market stress, the “appropriate timeline for submitting correcting trades [should] be five (5) business days.”⁹⁸

IECA supports flexible methods of execution for error trades.⁹⁹ IECA believes that allowing flexible methods of execution for error trades “will encourage SEFs to develop new and innovative trade execution methods” for error trades and the development of new and innovative execution methods may result in commercial end-users and their hedging affiliates to execute more transactions on SEF.¹⁰⁰ Further, IECA requested that the Commission clarify that § 37.203(a)’s prohibition of pre-arranged trading does not apply to error trades.¹⁰¹

3. Commission Determination

The Commission has determined to adopt § 37.9(e) as proposed. Final § 37.9(e)(2)(i) requires that a SEF must maintain rules and procedures that are fair, transparent, consistent, and allow for timely resolution of an “error trade,” as defined

⁹⁶ *Id.* at 3-4.

⁹⁷ *Id.* at 4.

⁹⁸ IHS Markit at 8.

⁹⁹ IECA at 4.

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at 5.

under § 37.9(e)(1)(ii).¹⁰² The error trade rules in § 37.9(e) would apply to any error trade that occurs on a SEF, regardless of whether the swap is submitted for clearing or not.

As adopted, final § 37.9(e) would require a SEF to adopt rules to resolve error trades that involve swaps submitted for clearing. For an error trade rejected from clearing and therefore deemed void *ab initio*, final § 37.9(e)(2)(i)(A) would require a SEF to permit the counterparties to subsequently execute a correcting trade, as defined in § 37.9(e)(1)(i), through any method of execution offered by the SEF. For an error trade that has been accepted for clearing, § 37.9(e)(2)(i)(B) would require a SEF to permit the counterparties to subsequently execute both an offsetting trade, as defined in § 37.9(e)(1)(iii), and a correcting trade through any method of execution offered by the SEF. The Commission intends for its principles-based approach to provide SEFs with the flexibility to implement its error trade policy in a manner that is best suited to its trading and trade processing operations.

Under the principles-based approach adopted in this release, the Commission notes that a SEF would not be prohibited from incorporating the conditions contained within NAL No. 17-27, or implementing rules that allow market participants, *sua sponte*, to correct error trades that have been accepted for clearing with an *ex post facto* review by the SEF of the error trade, offsetting trade, and correcting trade on a T+1 basis as is contemplated by NAL No. 20-01. Further, these final rules would not preclude SEFs from deploying error trade rules and procedures which consider whether a transaction

¹⁰² As adopted, an “error trade” would be defined as any trade executed on or subject to the rules of a SEF that contains an operational or clerical error. With respect to “package transactions,” as defined under final § 37.9(d)(1), the Commission deems the submission of the component transactions in a sequence that causes a rejection from clearing of an individual component to constitute an operational error that could be resolved through a correcting trade under final § 37.9(e)(2)(i)(A). Market participants had previously informed the Commission that an individual component transaction may be rejected from clearing if prematurely submitted because the risk of that component, in isolation, could cause a trader to exceed its credit limit. Under a different submission sequence of component transactions to the DCO, however, the net risk of all of those transactions may not have exceeded the credit limit, thereby avoiding the rejection. The Commission emphasizes, however, the use of a corrective trade may only apply to the rejected component and otherwise would not apply to the other legs of the package transaction that have been accepted for clearing.

cancellation or price adjustment will adversely impact market integrity, facilitate market manipulation or other illegitimate activity, or otherwise violate the CEA, Commission regulations, or the SEF's rules. However, regardless of the error trade rules and procedures that a SEF may adopt, the Commission notes that pursuant to this adopting release such rules must be fair, transparent, and consistent.¹⁰³

Further, these final rules provide flexibility in the execution methods that a SEF may offer to counterparties to execute offsetting and correcting trades that involve swaps that are Required Transactions.¹⁰⁴ The Commission agrees with commenters that this flexibility would promote SEF operational efficiency by allowing SEFs to offer error trade protocols that are tailored to their markets and to allow identification and resolution of operational and clerical errors in a timely manner.¹⁰⁵ Without such flexibility, market participants with an error in Required Transactions would otherwise be prohibited from determining to resolve the error between themselves by entering into an offsetting trade or a new trade with the correct terms due to the execution method requirements under § 37.9(a)(2), which require that all Required Transactions be traded via either an Order Book or RFQ System.

The Commission also believes that the final error trade rules further the SEF statutory goals of promoting trading on SEFs and pre-trade price transparency in the swaps market.¹⁰⁶ These final rules provide flexibility to depart from required execution methods that are otherwise intended to advance those statutory goals; allowing counterparties to correctly and efficiently execute swaps with the intended terms and

¹⁰³ The Commission further reiterates that any SEF offering trading in swaps subject to the post-trade name give up prohibition under existing § 37.9(d) (re-designated to § 37.9(f) in this final rulemaking. *See supra* note 46) must ensure its rules and procedures for error trades allow for error trade remediation without disclosure of the identities of counterparties to one another. *See* Post-Trade Name Give-Up on Swap Execution Facilities, 85 FR 44693, 44701 (July 24, 2020).

¹⁰⁴ The Commission notes that swaps that are Permitted Transactions, including those that are submitted to a DCO for clearing, may already be executed through any method of execution offered by a SEF pursuant to § 37.9(c)(2).

¹⁰⁵ *See* Citadel at 1-3, IECA at 4, ISDA at 1, and TP ICAP SEFs at 3-4.

¹⁰⁶ *See* 7 U.S.C. 7b-3(e).

conditions, however, enhances market integrity on SEFs, which promotes SEF participation. Additionally, the Commission believes these final rules would also help to ensure that trade data, which market participants rely upon to inform their swaps trading decisions, accurately reflects prevailing market pricing at any given time.

The Commission agrees with Citadel that properly reporting error trade cancellations and correcting trades pursuant to parts 43 and 45 is important.¹⁰⁷ The Commission notes that the reporting requirements for error trade cancellations, correcting trades, and offsetting trades will depend upon the error trade rules that SEFs adopt under this principles-based approach. However, regardless of the error trade rules that are adopted by a SEF, the Commission wants to make clear that SEFs and market participants are responsible for ensuring that they comply with their respective reporting requirements in parts 43 and 45 of the Commission's regulations.

The final rules adopted in § 37.9(e)(2)(i) specify timeframes for executing and submitting correcting and offsetting trades for clearing. In particular, as noted above, for correcting trades associated with an error trade that has been rejected from clearing, § 37.9(e)(2)(i)(A) would require the SEF to submit the correcting trade for clearing to the registered DCO or exempt DCO as soon as technologically practicable, but no later than one hour after notice of the rejection to the relevant clearing members. For an offsetting trade and a correcting trade associated with an error trade that already has been accepted for clearing, final § 37.9(e)(2)(i)(B) requires the SEF to submit both types of trades to the registered DCO or exempt DCO as soon as technologically practicable, but no later than three days after the registered DCO or exempt DCO accepted the error trade for clearing.

IHS Markit recommended that correcting trades have up to five days to be submitted to clearing.¹⁰⁸ IHS Markit thought a five-day submission period was

¹⁰⁷ *Id.* at 3.

¹⁰⁸ *See* IHS Markit at 8.

particularly important during times of market stress.¹⁰⁹ The Commission notes that IHS Markit does not provide or offer any support or background on why a five-day submission period is more appropriate than the timeframes proposed by the Commission in the Proposal. The Commission believes that the timeframes adopted in this release are consistent with the goal of promoting straight-through processing. The timing requirements are intended to provide a SEF and the counterparties to an error trade with an appropriate amount of time to identify and resolve error trades, while also minimizing delays to achieving prompt and efficient clearing of transactions. Therefore, the Commission declines to adopt IHS Markit's recommendation that correcting trades have up to five days to be submitted to clearing.

Further, final § 37.9(e)(2)(i) would require SEFs to have error trade rules and procedures that require market participants to provide prompt notice to the SEF of an error trade and, as applicable, the corresponding correcting trade and offsetting trade.¹¹⁰ Such notice need not be separate from the error trade correction process.

The Commission agrees with the TP ICAP SEFs that SEFs should have error trade rules and procedures that require market participants to provide prompt notice to the SEF of an error trade and, as applicable, the corresponding correcting trade and offsetting trade. The Commission believes that such a requirement is important to facilitate SEFs' fulfillment of their self-regulatory obligations. In particular, the Commission believes that providing a SEF prompt notice that an error trade has occurred on its trading system(s) or platform(s) will further enable it to facilitate direct supervision of its markets in order to

¹⁰⁹ *See id.*

¹¹⁰ To the extent a SEF implements error trade rules and procedures that allow market participants to correct error trades *sua sponte* with an *ex post facto* review by the SEF, that SEF must require that market participants notify it of the subsequent correcting and offsetting trades. Conversely, a SEF that adopts error trade rules and procedures in which the SEF is responsible for correcting the error trade, that SEF would not be required to have market participants notify it of the subsequent correcting and offsetting trades. Regardless of the type of error trade rules and procedures a SEF adopts, it is required to adopt rules and procedures which require its market participants to provide prompt notice to it of an error trade that has occurred on its trading system(s) or platform(s).

determine whether a rule violation has occurred as required under § 37.203(b), as well as enhance its ability to carry out real-time market monitoring of all trading activity on its system(s) or platform(s) to identify disorderly trading and any market or system anomalies pursuant to § 37.203(e).¹¹¹

Final § 37.9(e)(2)(ii) would prohibit counterparties from executing a second correcting trade to fix an error trade if the initial correcting trade is rejected from clearing. The Commission believes that limiting the number of instances in which counterparties may attempt to correct an error trade will help to facilitate prompt and efficient clearing by incentivizing the counterparties to accurately execute their correcting trade as quickly as possible.

IECA requests that the Commission clarify that application of the pre-arranged trading prohibition under Commission regulation 37.203(a).¹¹² The Commission notes that the existing prohibition already provides an exception to that prohibition by allowing a SEF to adopt trading practices that are certified or approved by the Commission pursuant to part 40 of the Commission's regulations.¹¹³ Accordingly, the Commission anticipates that a SEF would implement final § 37.9(e) by self-certifying or adopting rules subject to Commission review under part 40 that specify the manner in which counterparties may execute offsetting and correcting trades.

Therefore, for the reasons stated above, the Commission is adopting § 37.9(e) as proposed.¹¹⁴

III. Effective Date

The Commission proposed an effective date for the Proposal to be 60 days after publication of final regulations in the *Federal Register*. The Commission received no

¹¹¹ See 17 CFR 37.203(b); 17 CFR 37.203(e).

¹¹² See IECA at 5.

¹¹³ See 17 CFR 37.203(a).

¹¹⁴ The Commission notes that upon the effective date of these rules, the adoption of § 37.9(e) will negate the need for the relief provided in NAL No. 17-27 and NAL No. 20-01.

comments regarding the effective date. Therefore, the Commission is adopting an effective date for these rules for 60 days after publication of final regulations in the *Federal Register*. The Commission believes that such an effective date allows SEFs and market participants sufficient time to adapt to the amended and additional rules in an efficient and orderly manner.

IV. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (“RFA”)¹¹⁵ requires Federal agencies, in promulgating regulations, to consider the impact of those regulations on small businesses. The regulations adopted herein will affect SEFs and their market participants. The Commission has previously established certain definitions of “small entities” to be used by the Commission in evaluating the impact of its regulations on small entities in accordance with the RFA.¹¹⁶ The Commission previously concluded that SEFs are not small entities for the purpose of the RFA.¹¹⁷ The Commission has also previously stated its belief in the context of relevant rulemakings that SEFs’ market participants, which are all required to be ECPs¹¹⁸ as defined in section 1a(18) of the CEA,¹¹⁹ are not small entities for purposes of the RFA.¹²⁰ The Commission received no comment on whether SEFs and SEF market participants covered by these final rules should be considered small entities for the purpose of the RFA. Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the regulations will not have a significant economic impact on a substantial number of small entities.

¹¹⁵ 5 U.S.C. 601 *et seq.*

¹¹⁶ 47 FR 18618 – 18621 (Apr. 30, 1982).

¹¹⁷ SEF Core Principles Final Rule, 78 FR 33476, 33548 (June 4, 2013) (citing 47 FR 18618, 18621 (Apr. 30, 1982) (discussing DCMs); 66 FR 42256, 42268 (Aug. 10, 2001) (discussing derivatives transaction execution facilities, exempt commercial markets, and exempt boards of trade); and 66 FR 45604, 45609 (Aug. 29, 2001) (discussing registered DCOs)).

¹¹⁸ 17 CFR 37.703.

¹¹⁹ 7 U.S.C. 1(a)(18).

¹²⁰ 66 FR 20740, 20743 (Apr. 25, 2001) (stating that ECPs by the nature of their definition in the CEA should not be considered small entities).

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995, 44 U.S.C. 3501 *et seq.* (“PRA”) imposes certain requirements on Federal agencies (including the Commission) in connection with conducting or sponsoring any “collection of information,”¹²¹ as defined by the PRA. Among its purposes, the PRA is intended to minimize the paperwork burden to the private sector, to ensure that any collection of information by a government agency is put to the greatest possible use, and to minimize duplicative information collections across the government.¹²²

The PRA applies to all information, regardless of form or format, whenever the government is obtaining, causing to be obtained, or soliciting information, and includes required disclosure to third parties or the public, of facts or opinions, when the information collection calls for answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, ten or more persons.¹²³ The PRA requirements have been determined to include not only mandatory, but also voluntary information collections, and include both written and oral communications.¹²⁴ The Commission may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid Office of Management and Budget (“OMB”) control number.

This final rulemaking contains collections of information for which the Commission has previously received control numbers from OMB. The titles for these collections of information are “Core Principles and Other Requirements for Swap Execution Facilities, OMB control number 3038-0074” and “Part 40, Provisions Common to Registered Entities, OMB control number 3038-0093.” This final rulemaking

¹²¹ See 44 U.S.C. 3502(3)(A).

¹²² See 44 U.S.C. 3501.

¹²³ See 44 U.S.C. 3502(3).

¹²⁴ See 5 CFR 1320.3(c)(1).

would not impose any new information collection requirements from any persons or entities that require approval of OMB under the PRA.

C. Cost-Benefit Considerations

Section 15(a) of the CEA¹²⁵ requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors.

1. Background

The Commission is amending certain rules in parts 36 and 37 of its regulations relating to the execution of the swap components of certain package transactions on SEFs and the resolution of error trades on SEFs.

The baseline against which the Commission considers the costs and benefits of these final rules is the statutory and regulatory requirements of the CEA and Commission regulations now in effect, in particular CEA section 5h and certain rules in part 37 of the Commission's regulations. The Commission, however, notes that as a practical matter SEFs and market participants have adopted some current practices based upon no-action relief provided by Commission staff that is time-limited in nature.¹²⁶ As such, to the

¹²⁵ 7 U.S.C. 19(a).

¹²⁶ In its discussion of cost-benefit considerations, the Commission believes it is also relevant to consider the costs and benefits of the final regulations in comparison to circumstances in which such no-action relief has expired and is no longer available. The Commission further notes that in connection with NAL No. 16-58 and its extension NAL No. 17-27 (relief related to clerical or operational error trade resolution), market participants specifically requested that the Commission undertake rulemakings to establish a permanent solution for addressing these clerical and operational errors, rather than merely extending the previous NAL relief. *See* NAL No. 16-58 and NAL No. 17-27. In contrast, previous requests for no-action relief from market participants for the NALs which preceded NAL No. 16-58 and NAL No. 17-27 were merely for temporary relief.

extent that SEFs and market participants have relied on relevant staff no-action letters, the actual costs and benefits of the final rules as realized in the market may not be as significant.

In some instances, it is not reasonably feasible to quantify the costs and benefits to SEFs and certain market participants with respect to certain factors, for example, market integrity. Notwithstanding these types of limitations, however, the Commission otherwise identifies and considers the costs and benefits of these rules in qualitative terms. The Commission did not receive any comments from commenters which quantified or attempted to quantify the costs and benefits of the Proposal.

The following consideration of costs and benefits is organized according to the rules and rule amendments proposed in this release. For each rule, the Commission summarizes the amendments, identifies and discusses the costs and benefits attributable to such rule, and identifies and discusses alternatives that the Commission considered. The Commission, where applicable, then considers the costs and benefits of the final rules in light of the five public interest considerations set out in section 15(a) of the CEA.

The Commission notes that this consideration of costs and benefits is based on the understanding that the swaps market functions internationally, with many transactions involving U.S. firms taking place across international boundaries, with some Commission registrants being organized outside of the United States, with leading industry members typically conducting operations both within and outside the United States, and with industry members commonly following substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the discussion of costs and benefits below refers to the effects of the final rules on all swaps activity subject to the amended regulations, whether by virtue of the activity's physical

location in the United States or by virtue of the activity's connection with activities in, or effect on, U.S. commerce under CEA section 2(i).¹²⁷

2. Package Transactions

The Commission is adding § 37.9(d) and amending § 37.9(a)(2) to permit the swap components of certain package transactions to be executed via flexible methods of execution pursuant to § 37.9(c)(2). The final rules define a “package transaction” as a transaction consisting of two or more component transactions executed between two or more counterparties where (i) at least one component transaction is subject to the trade execution requirement in section 2(h)(8) of the Act;¹²⁸ (ii) execution of each component transaction is contingent upon the execution of all other component transactions; and (iii) the component transactions are priced or quoted together as one economic transaction with simultaneous or near-simultaneous execution of all components. Based on this definition and consistent with existing no-action relief, the final rule allows the swap component of the following three categories of package transactions to be executed via flexible means of execution pursuant to § 37.9(c)(2): (1) MAT/Non-MAT Uncleared package transactions; (2) MAT/Non-Swap Instrument package transactions;¹²⁹ and (3) MAT/Non-Exclusive CFTC Swap package transactions.

In addition, the Commission is relieving the swap components of these three types of package transactions from the requirement in § 37.3 that the SEF offer an Order Book for every swap listed for trading on the SEF, while continuing to require that SEFs offer an Order Book for outright transactions in every swap listed for trading on the SEF.

¹²⁷ Section 2(i)(1) applies the swaps provisions of both the Dodd-Frank Act and Commission regulations promulgated under those provisions to activities outside the United States that have a direct and significant connection with activities in, or effect on, commerce of the United States. 7 U.S.C. 2(i)(1). Section 2(i)(2) makes them applicable to activities outside the United States that contravene Commission rules promulgated to prevent evasion of Dodd-Frank.

¹²⁸ Note prong (i) of the package transaction definition in § 37.9(d)(1) states “at least one component transaction is a Required Transaction” which is substantively the same as prong (i) of the definition used above.

¹²⁹ Under final § 37.9(d)(3), consistent with the no-action relief, this category specifically excludes U.S. Dollar Spreadover package transactions; MAT/Futures package transactions, MAT/Agency MBS package transactions; and New Issuance Bond package transactions.

Finally, the Commission is using its exemptive authority pursuant to CEA section 4(c) to exempt swap transactions that are executed as a component of a package transaction that includes a component that is a new issuance bond from the trade execution requirement under section 2(h)(8) of the Act.

Benefits: The final rule will allow market participants to choose the most suitable execution method for each package transaction and will allow SEFs to continue to offer flexible execution methods for these package transactions rather than only offer the required methods of execution for swaps subject to the trade execution requirement. The Commission expects this will reduce execution risks, improve efficiency, and decrease transaction costs as market participants will be able to avoid legging into transactions, that is, entering into each part of the package separately. The Commission notes that these benefits are currently available to market participants through existing no-action relief. The Commission further believes that the final rule will provide the liquidity and transparency benefits of increased trading of component swaps on SEFs, as without this flexibility, market participants would be unable or unwilling to trade such swap components through SEFs' required methods of execution.¹³⁰

The Commission believes that not requiring SEFs to offer an Order Book for the swap components of the three types of relevant package transactions will benefit SEFs by helping them to reduce operating costs, as they will no longer be required to operate and maintain an Order Book for trading those swaps that are components of those package transactions. However, SEFs will need to retain the availability of Order Books for those swaps executed as outright transactions.

Further, as discussed above, given the illiquid and bespoke nature of various components within the relevant package transactions, the Commission acknowledges that the Order Book is not the ideal method of execution for many of such transactions.

¹³⁰ See *supra* note 51.

Therefore, the Commission anticipates that if SEFs are not required to provide an Order Book for the swap components of the relevant package transactions that are not suitable for Order Book trading, SEFs will be able to more effectively employ their resources, and no longer face the prospect of being required to provide Order Books that will not be utilized given the complex, illiquid, and bespoke nature of various components of the relevant package transactions.

The Commission believes that exempting swap transactions that are executed as a component of a package transaction that includes a component that is a new issuance bond from the trade execution requirement will ensure that market participants such as bond underwriters and issuers can continue to execute these packages (where the new-issuance bond is hedged by an interest rate swap with tenor and payment terms that typically match the terms of the bond issuance) off-SEF. As discussed above, this exemption may facilitate new bond issuances, which may benefit capital formation by helping market participants to raise capital and fund origination loans for businesses and homeowners. Moreover, in light of the involvement of the bond issuer and the underwriter in arranging and executing a package transaction in conjunction with a new issuance bond and the unique negotiation and fit-for-purpose nature of these package transactions, the Commission understands that it remains difficult or impossible to trade these package transactions on a SEF. SEFs have not been able to design an execution method suitable for this particular type of package, rendering it impracticable to execute these packages on-SEF. While the swap components of many swap/new-issuance bond packages executed today are not currently subject to the trade execution requirement,¹³¹ the final rule will ensure that those transactions would remain exempt in the event the trade execution requirement is expanded to include more types of swaps.

¹³¹ For example, the swap component may be a forwarding-starting swap whose start date corresponds to the issuance date of the bond. Forward starting swaps are not currently subject to the trade execution requirement.

Costs: The amendments to allow flexible execution methods for certain package transactions and the exemption for package transactions that include a new issuance bond should not impose costs on market participants since they only provide flexibility to market participants and do not require them to change their current trade practices. Moreover, to the extent that market participants are relying on existing no-action relief, they can continue to implement existing industry practice. The Commission believes that current SEF rules typically allow participants to utilize flexible execution methods pursuant to the existing no-action relief, but to the extent that SEFs need to modify their rules to incorporate the amendments, they may incur modest costs.

As noted, not requiring SEFs to offer an Order Book for the swap components of the relevant package transactions may enable SEFs to reduce operating costs. Since any existing Order Books for swap components of the relevant package transactions are not actively used and are not practicable for market participants to use, removing these Order Books (and not requiring SEFs to create such Order Books) should not impose significant costs on market participants.

Section 15(a) Factors

a. Protection of Market Participants and the Public

The Commission believes that the amendments and exemption will protect market participants from the risks associated with logging into the relevant packages by enabling market participants to enter into package transactions using appropriate execution methods. Permitting SEFs to eliminate the Order Book for use when swaps are components of the relevant package transactions should not impact protection of market participants. While protecting market participants also benefits the public, the Commission has not identified any further effect of the final rules on protection of the public.

b. Efficiency, Competitiveness, and Financial Integrity of the Markets

The amendments will enhance efficiency by enabling market participants to continue to execute the swap components of the relevant packages in a single transaction with an appropriate execution method, rather than via the inefficient process of legging into the package one component at a time. The amendments will also enhance financial integrity by enabling market participants to continue to avoid the execution risk associated with potential adverse price movements while attempting to leg into a transaction. The Commission has not identified any likely effects of the final rule amendments on competition in the swap markets. The Commission expects that, since there are few, if any, active Order Books for swaps as components of the relevant package transactions, SEFs will not use final § 37.3(a)(4) to remove active Order Books that are providing competitive markets.

c. Price Discovery

Package transactions are typically executed at a single price for the entire package, rather than at the prices of the individual components. The amendments will continue to allow the relevant package transactions to be executed using the execution methods that are designed to facilitate price discovery in these packages. For packages that include new issuance bonds, the exemption will permit price discovery to occur at the appropriate venue. The Commission believes that § 37.3(a)(4), which exempts swaps that are part of the relevant package transactions from the Order Book requirement, will not materially inhibit price discovery since the Commission anticipates that SEFs would retain Order Books where price discovery is occurring and that currently price discovery is not occurring in Order Books for swap components of the package transactions addressed within this final rule.

d. Sound Risk Management Practices

The Commission believes that the final rules will continue to promote sound risk management by facilitating the execution of package transactions as market participants

consider package transactions to often be useful and appropriate instruments for management and transfer of risk and to avoid the execution risks associated with legging of transactions.

e. Other Public Interest Considerations

The exemption from the trade execution requirement for the swap components of packages involving new issuance bonds may help promote capital formation by facilitating the issuance of bonds to raise capital. The Commission has not identified any other effect of the final rules and exemption regarding package transactions on other public interest considerations.

3. Error Trades

The Commission is adding subsection (e) to § 37.9 to establish a flexible SEF error trade policy standard that, among other things, incorporates the intent of the existing no-action relief in NAL No. 17-27 for resolving errors in Required Transactions. Final § 37.9(e)(2)(i) specifies that a SEF must maintain rules and procedures that are “fair, transparent, consistent” and “allow for timely resolution” of an “error trade,” as defined under final § 37.9(e)(1)(ii). This standard applies to any error trade that occurs on a SEF, regardless of whether or not the swap is submitted for clearing. Further, under final § 37.9(e)(2)(i), SEFs must have error trade rules and procedures that require that market participants provide prompt notice to the SEF of an error trade and, as applicable, correcting and offsetting trades.

Final § 37.9(e) also requires a SEF to adopt rules to resolve error trades that involve swaps submitted for clearing. For an error trade rejected from clearing and therefore deemed void *ab initio*, final § 37.9(e)(2)(i)(A) requires a SEF to permit the counterparties to subsequently execute a correcting trade, as defined in § 37.9(e)(1)(i), through any method of execution offered by the SEF. For an error trade that has been accepted for clearing, final § 37.9(e)(2)(i)(B) requires a SEF to permit the counterparties

to subsequently execute both an offsetting trade, as defined in final § 37.9(e)(1)(iii), and a correcting trade through any method of execution offered by the SEF.

The final rule includes some limitations that are similar to the existing no-action relief, including specified timeframes for executing and submitting these trades for clearing. For correcting trades associated with an error trade that has been rejected from clearing, final § 37.9(e)(2)(i)(A) requires the SEF to submit the correcting trade for clearing to the registered DCO or exempt DCO as soon as technologically practicable, but no later than one hour after notice of the rejection to the relevant clearing members. For an offsetting trade and a correcting trade associated with an error trade that already has been accepted for clearing, final § 37.9(e)(2)(i)(B) requires the SEF to submit both types of trades to the registered DCO or exempt DCO as soon as technologically practicable, but no later than three days after the registered DCO or exempt DCO accepted the error trade for clearing. In addition to these timeframes, final § 37.9(e)(2)(ii) prohibits counterparties from executing a second correcting trade to fix an error trade if the initial correcting trade is rejected from clearing.

However, the final rule does not include certain additional conditions applicable to SEFs and counterparties that are contained in the no-action relief under NAL No. 17-27 or NAL No. 20-01. For example, the no-action relief in NAL No. 17-27 requires that a SEF must make an affirmative finding that an alleged error trade has occurred and must have rules setting forth the procedures for making such a finding.

Benefits: Absent the adoption of these rules, both SEFs and market participants would need to comply with the existing Commission regulations, notwithstanding the significant procedural and logistical difficulties of doing so. In particular, market participants would have to resolve error trades in Required Transactions using the Order Book or RFQ System, which would likely make it impossible to recreate the trade as originally intended. These difficulties could dissuade SEFs from being actively involved

in the error trade resolution process and market participants from executing swaps on a SEF. The Commission believes that the final rule will avoid these potential difficulties.

The Commission believes that, given that the amendments are largely consistent with current industry practice, SEFs and market participants may likely have already realized much of the benefit of final § 37.9(e). The Commission believes, however, that the final rules additionally will provide a tangible benefit to market participants on a longer-term basis by allowing market participants to continue utilizing policies and protocols which the Commission understands most SEFs adopted in reliance upon the relief provided in existing no-action letters to resolve error trades.

The requirement under § 37.9(e)(2)(i) that market participants provide prompt notice to a SEF of an error trade and, as applicable, the corresponding correcting trade and offsetting trade will benefit SEFs in carrying out their self-regulatory obligations. In particular, the Commission believes that providing SEFs prompt notice that an error trade has occurred on their trading system(s) or platform(s) will enhance their ability to carry out real-time market monitoring of all trading activity on their system(s) or platform(s) to identify disorderly trading and any market or system anomalies or violations of SEF rules.

The Commission also believes that the amendments will facilitate the goal of promoting consistency in the swaps market with respect to how errors are evaluated and resolved. First, the amendments will require all SEFs to adopt such policies. To the extent SEFs have not yet implemented such policies, the amendments will benefit market participants who will now be able to correct error trades and avoid related economic losses. Further, market participants can obtain the benefit of executing a swap transaction that corrects an error trade with the terms originally intended.

Finally, some SEFs have already implemented robust error trade resolution policies pursuant to existing no-action relief, while other SEFs have not implemented

robust error trade policies. This inconsistency among SEFs could otherwise cause a “race to the bottom” for SEFs’ compliance and market oversight, as certain market participants may prefer SEFs with less stringent error trade policies. As a result, SEFs that have implemented robust error trade policies—and the swaps market in general—will benefit by eliminating this potential “race to the bottom,” and the Commission will underscore the importance of SEF market oversight by adopting such requirements in Commission regulations.¹³²

Costs: Similar to the conditions established by Commission staff in time-limited no-action relief, the amendments would require SEFs to establish rules implementing various policies and procedures for resolving error trades. Under the final rules, SEFs must submit new rules to the Commission pursuant to part 40 of the Commission’s regulations. However, the Commission understands that pursuant to the existing no-action relief, most SEFs currently have rules that otherwise comply with the adopted regulations. SEFs may choose to adjust their rules in light of the absence in the final rules of the requirement in the no-action relief that SEFs affirmatively determine that an error trade has occurred.¹³³ To the extent that SEFs must draft and submit new rules to the Commission, the Commission estimates that the costs will be modest.

The Commission believes that the amendments will not impose significant additional costs on market participants and intermediaries, because resolving error trades is inherently costly regardless of regulations imposed by the Commission, and market participants and intermediaries are currently subject to SEF policies and procedures. The requirement that market participants provide prompt notice to a SEF of an error trade

¹³² The Commission notes that a robust error trade resolution policy is also consistent with an effective compliance and oversight program because the ability to resolve error trades (i) helps protect market integrity by unwinding certain error trades that otherwise would have an adverse effect on the market and (ii) promotes legal certainty by ensuring that market participants obtain the economic position in the transaction that they intended.

¹³³ In light of the flexibility of the final rules, SEFs can continue to require such an affirmative declaration if they determine that such requirement provides benefits to market participants or the SEF.

and, as applicable, the correcting trade and offsetting trade will impose modest costs on market participants. In practice, though, market participants have likely needed to report error trades to SEFs in order to facilitate SEF determinations that an error trade has occurred pursuant to NAL No. 17-27, and would have had to report the correcting trade and offsetting trade in order to facilitate the SEF's *ex post facto* review pursuant to NAL No. 20-01. Not requiring that a SEF find that an error trade has occurred either before it has been resolved or via an *ex post facto* review should impose only minor costs on market participants associated with changes in procedures to no longer request that a SEF make such a determination.

The Commission notes that NAL No. 17-27 and NAL No. 20-01 apply to both SEFs and DCMs, but the final rule applies only to SEFs. Therefore, the Commission believes that the final rule will impose no costs on DCMs, and notes that no DCM is currently availing itself of the no-action relief.

Section 15(a) Factors

a. Protection of Market Participants and the Public

The addition of § 37.9(e) regarding error trades will protect market participants and the public by providing SEFs with greater authority under Commission regulations to resolve error trades. Further, by providing SEFs with the authority to permit counterparties to execute correcting trades and offsetting trades, the final rule amendments will protect market stability and transparency by preventing potential losses to market participants in connection with error trades and reducing instances in which market participants rely on inaccurate pricing information to inform their trading decisions. The addition of § 37.9(e) will also promote greater transparency of the error trade resolution process to SEFs' market participants as SEFs will be required to establish policies and procedures for reviewing and determining how to resolve alleged error trades. The adopted requirement under § 37.9(e)(2)(i) that market participants provide

prompt notice to a SEF of an error trade and, as applicable, the correcting trade and offsetting trade will promote protection of market participants and the public by enhancing a SEF's ability to carry out its market oversight and monitoring responsibilities. The Commission believes that the absence of a requirement in the final rule that SEFs must affirmatively determine, or determine after an *ex post facto* review, that an error trade has occurred (which are conditions in the existing no-action relief under NAL No. 17-27 and NAL No. 20-01) will not materially impact the protection of market participants and the public.

b. Efficiency, Competitiveness, and Financial Integrity of the Markets

The addition of § 37.9(e) may improve the efficiency and financial integrity of markets by enabling counterparties to correct operational or clerical errors in a swap transaction. In particular, the final rules will help promote greater trading accuracy in the market by allowing counterparties to ultimately carry out transactions as originally intended, and would avoid unexpected trading losses caused by error trades. The requirement under § 37.9(e)(2)(i) that market participants provide prompt notice to a SEF of an error trade and, as applicable, the correcting trade and offsetting trade would enhance a SEF's ability to carry out its market oversight and monitoring responsibilities, which helps promote the financial integrity of its markets. The Commission believes that the absence of the no-action provision that SEFs must affirmatively determine that an error trade has occurred could enhance the efficiency of the error trade resolution process and would not materially impact the competitiveness or financial integrity of the swap market on SEFs.

Absent these final rules, counterparties would be required in certain circumstances to correct or re-execute swap transactions in a less efficient and effective manner on a SEF, such as through the required methods of execution under § 37.9(a). The final rules, which also require SEFs to adopt certain policies and procedures for

addressing error trades, should further promote efficiency in the resolution process by providing market participants that transact on multiple SEFs with a more consistent approach across different platforms for correcting error trades.

c. Price Discovery

The addition of § 37.9(e) regarding error trades will enable SEFs to correct error trades containing a clerical or operational error while maintaining the price discovery benefits associated with the pre-trade transparency requirements of § 37.9. In particular, the final rules will help promote price discovery by allowing counterparties, whose original trade has been cancelled upon rejection from clearing due to a clerical or operational error, to re-execute the trade with the terms as originally intended. For error trades that have been accepted by a registered DCO or exempt DCO for clearing, the final rules promote greater accuracy in the price discovery process by allowing the counterparties to correct the error trade by executing an offsetting swap transaction and a correcting swap transaction with the terms as originally intended.

d. Sound Risk Management Practices

The addition of § 37.9(e) regarding error trades may promote sound risk management practices by providing SEFs with greater authority under Commission regulations to facilitate error trade resolution. The final rules will help to mitigate potential losses to market participants arising out of trade cancellations, where the error trade is rejected from clearing, or arising from maintaining the position of an unintended error trade.

e. Other Public Interest Considerations

The Commission has not identified any effect of § 37.9(e) on other public interest considerations.

Consideration of Alternatives. Commenters were generally supportive of the proposed rules and recommended only one viable alternative.¹³⁴ IHS Markit recommended with respect to the error trade rules that, especially during periods of market stress, the “appropriate timeline for submitting correcting trades [should] be five (5) business days.”¹³⁵ As discussed above, under final § 37.9(e)(2)(i), a SEF must submit a correcting trade for clearing to the registered DCO or exempt DCO as soon as technologically practicable, but no later than one hour (if rejected for clearing) or three days (if accepted for clearing) after notice of the error trade. The Commission notes that the final rule is the same as the requirements of the no-action relief and that SEFs have successfully implemented error trade procedures consistent with the no-action relief and, thus, the final rule. SEFs have not indicated to the Commission that the deadlines are overly costly or burdensome. Moreover, during the recent period of market stress associated with the COVID-19 pandemic, no SEF requested relief from the error trade requirements. The Commission has therefore determined not to adopt the alternative recommended by IHS Markit.

The Commission considered adopting new rules identical to the no-action relief but determined, based on SEFs’ and the Commission’s experience with the no-action relief, to adopt changes where appropriate relative to the no-action relief. In particular, the final rule does not contain the requirement that a SEF affirmatively determine that an error trade has occurred, either before resolution or via an *ex post facto* review. The Commission believes that such a requirement would impose unnecessary costs on SEFs and market participants, and potentially impair the efficiency of the error trade resolution

¹³⁴ As discussed above, commenters did recommend several other potential Commission actions that are outside the scope of this rulemaking and are therefore not addressed in this consideration of costs and benefits. Further, commenters did not specifically comment on the Commission’s consideration of costs and benefits in the Proposal. To the extent that comments addressed issues bearing on the Commission’s consideration of costs and benefits, they are discussed above in section II; the cost-benefit considerations discussion incorporates previous discussion of comments relevant to costs and benefits by reference.

¹³⁵ IHS Markit at 8.

process. To the extent that SEFs and market participants are currently availing themselves of current no-action relief, they therefore may realize reduced costs under the final rule.

D. Antitrust Considerations

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of the CEA, in issuing any order or adopting any Commission rule or regulation. The Commission does not anticipate that the amendments to parts 36 and 37 will promote or result in anti-competitive consequences or behavior.

List of Subjects

17 CFR Part 36

Package transactions, Trade execution requirement.

17 CFR Part 37

Error trades, Package transactions, Required methods of execution, Swap execution facilities, Swaps, Trade execution requirement.

For the reasons stated in the preamble, the Commodity Futures Trading Commission amends 17 CFR chapter I as follows:

1. Revise part 36 to read as follows:

PART 36 – TRADE EXECUTION REQUIREMENT

Authority: 7 U.S.C. 1a, 2, 5, 6, 6c, 7, 7a-2, and 7b-3, as amended by Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

§ 36.1 Exemptions to trade execution requirement.

(a) A swap transaction that is executed as a component of a package transaction that also includes a component transaction that is the issuance of a bond in a primary market is exempt from the trade execution requirement in section 2(h)(8) of the Act.

(1) For purposes of paragraph (a) of this section, a package transaction consists of two or more component transactions executed between two or more counterparties where:

(i) At least one component transaction is subject to the trade execution requirement in section 2(h)(8) of the Act;

(ii) Execution of each component transaction is contingent upon the execution of all other component transactions; and

(iii) The component transactions are priced or quoted together as one economic transaction with simultaneous or near-simultaneous execution of all components.

(2) [Reserved]

(b) [Reserved]

PART 37 – SWAP EXECUTION FACILITIES

2. The authority citation for part 37 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6c, 7, 7a-2, 7b-3, and 12a, as amended by Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376.

3. In § 37.3, add paragraph (a)(4) to read as follows:

§ 37.3 Requirements and procedures for registration.

(a) * * *

(4) A swap execution facility is not required to provide an order book under this section for transactions defined in § 37.9(d)(2), (3), and (4), except that a swap execution facility must provide an order book under this section for Required Transactions that are components of transactions defined in § 37.9(d)(2), (3), and (4) of this part when such Required Transactions are not executed as components of transactions defined in § 37.9(d)(2), (3), and (4).

* * * * *

4. Amend § 37.9 by:

- a. Revising introductory text of paragraph (a)(2)(i);
- b. Redesignating paragraph (d) as paragraph (f);
- c. Adding new paragraphs (d) and (e); and
- c. Revising newly redesignated paragraph (f).

The additions and revisions read as follows:

§ 37.9 Methods of execution for required and permitted transactions.

(a) * * *

(2) * * *

(i) Each Required Transaction that is not a block trade as defined in § 43.2 of this chapter shall be executed on a swap execution facility in accordance with one of the following methods of execution except as provided in paragraph (d) or (e) of this section:

* * * * *

(d) *Exceptions to required methods of execution for package transactions.* (1) For purposes of this paragraph, a package transaction consists of two or more component transactions executed between two or more counterparties where:

- (i) At least one component transaction is a Required Transaction;
- (ii) Execution of each component transaction is contingent upon the execution of all other component transactions; and
- (iii) The component transactions are priced or quoted together as one economic transaction with simultaneous or near-simultaneous execution of all components.

(2) A Required Transaction that is executed as a component of a package transaction that includes a component swap that is subject exclusively to the Commission's jurisdiction, but is not subject to the clearing requirement under section 2(h)(1)(A) of the Act, may be executed on a swap execution facility in accordance with paragraph (c)(2) of this section as if it were a Permitted Transaction;

(3) A Required Transaction that is executed as a component of a package transaction that includes a component that is not a swap, as defined under section 1a(47) of the Act, may be executed on a swap execution facility in accordance with paragraph (c)(2) of this section as if it were a Permitted Transaction. This provision shall not apply to:

(i) A Required Transaction that is executed as a component of a package transaction in which all other non-swap components are U.S. Treasury securities;

(ii) A Required Transaction that is executed as a component of a package transaction in which all other non-swap components are contracts for the purchase or sale of a commodity for future delivery;

(iii) A Required Transaction that is executed as a component of a package transaction in which all other non-swap components are agency mortgage-backed securities; and

(iv) A Required Transaction that is executed as a component of a package transaction that includes a component transaction that is the issuance of a bond in a primary market.

(4) A Required Transaction that is executed as a component of a package transaction that includes a component swap that is not exclusively subject to the Commission's jurisdiction may be executed on a swap execution facility in accordance with paragraph (c)(2) of this section as if it were a Permitted Transaction.

(e) *Resolution of operational and clerical error trades.* (1) As used in this paragraph:

(i) *Correcting trade* means a trade executed and submitted for clearing to a registered derivatives clearing organization, or a derivatives clearing organization that the Commission has determined is exempt from registration, with the same terms and

conditions as an error trade other than any corrections to any operational or clerical error and the time of execution.

(ii) *Error trade* means any trade executed on or subject to the rules of a swap execution facility that contains an operational or clerical error.

(iii) *Offsetting trade* means a trade executed and submitted for clearing to a registered derivatives clearing organization, or a derivatives clearing organization that the Commission has determined is exempt from registration, with terms and conditions that economically reverse an error trade that was accepted for clearing.

(2) *Execution of correcting trades and offsetting trades.* (i) A swap execution facility shall maintain rules and procedures that facilitate the resolution of error trades. Such rules shall be fair, transparent, and consistent; allow for timely resolution; require market participants to provide prompt notice of an error trade—and, as applicable, offsetting and correcting trades—to the swap execution facility; and permit market participants to:

(A) Execute a correcting trade, in accordance with paragraph (c)(2) of this section, regardless of whether it is a Required or Permitted Transaction, for an error trade that has been rejected from clearing as soon as technologically practicable, but no later than one hour after a registered derivatives clearing organization, or a derivatives clearing organization that the Commission has determined is exempt from registration, provides notice of the rejection; or

(B) Execute an offsetting trade and a correcting trade, in accordance with paragraph (c)(2) of this section, regardless of whether it is a Required or Permitted Transaction, for an error trade that was accepted for clearing as soon as technologically practicable, but no later than three days after the error trade was accepted for clearing at a derivatives clearing organization or a derivatives clearing organization that the Commission has determined is exempt from registration.

(ii) If a correcting trade is rejected from clearing, then a swap execution facility shall not allow the counterparties to execute another correcting trade.

(f) *Counterparty anonymity.* (1) Except as otherwise required under the Act or the Commission's regulations, a swap execution facility shall not directly or indirectly, including through a third-party service provider, disclose the identity of a counterparty to a swap that is executed anonymously and intended to be cleared.

(2) A swap execution facility shall establish and enforce rules that prohibit any person from directly or indirectly, including through a third-party service provider, disclosing the identity of a counterparty to a swap that is executed anonymously and intended to be cleared.

(3) For purposes of paragraphs (f)(1) and (2) of this section, “executed anonymously” shall include a swap that is pre-arranged or pre-negotiated anonymously, including by a participant of the swap execution facility.

(4) For a package transaction that includes a component transaction that is not a swap intended to be cleared, disclosing the identity of a counterparty shall not violate paragraph (f)(1) or (2) of this section. For purposes of this paragraph, a “package transaction” consists of two or more component transactions executed between two or more counterparties where:

(i) Execution of each component transaction is contingent upon the execution of all other component transactions; and

(ii) The component transactions are priced or quoted together as one economic transaction with simultaneous or near-simultaneous execution of all components.

Issued in Washington, DC, on November 27, 2020, by the Commission.

Robert Sidman,

Deputy Secretary of the Commission.

NOTE: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Swap Execution Facility Requirements—Voting Summary and Chairman’s and Commissioners’ Statements

Appendix 1—Voting Summary

On this matter, Chairman Tarbert and Commissioners Quintenz, Behnam, Stump, and Berkovitz voted in the affirmative. No Commissioner voted in the negative.

Appendix 2—Supporting Statement of Chairman Heath P. Tarbert

I am pleased to support today’s final rule amending Part 36 and Part 37 of the CFTC’s regulations relating to swaps. These amendments codify staff no-action letters in two areas: (1) package transactions and (2) error trades.

Before the 2008 financial crisis, swaps were executed bilaterally “over the counter,” rather than on a centralized exchange. When crafting the Dodd-Frank Act in 2010, Congress faced a key decision: Should it require swaps to trade like futures, via a centralized exchange order book visible to the entire market of potential buyers and sellers? Or should it retain the old bilateral, off-exchange trading practices?

This was a difficult decision. After all, the crisis highlighted the need for more effective price discovery in our swaps markets.¹ For more than a century, centralized exchanges have supported price discovery in futures products by providing a liquid, transparent market for buyers (longs) and sellers (shorts) to come together and transact. On the other hand, swaps are not futures. Many swaps products are executed only episodically through the negotiation of bespoke terms. In the 1990s and 2000s, this was done primarily through brokers and dealers providing quotes to one another on the telephone or over email. Hence, anonymous electronic trading via a central limit order

¹ See Committee on Capital Markets Regulation, *The Global Financial Crisis: A Plan for Regulatory Reform* 55 (May 2009) (With the real-time availability of both pre-trade quotes and post-trade contract prices, an exchange would thus provide an important source of price discovery that would complement the OTC market and enhance its liquidity.); Federal Reserve Bank of Chicago, *Derivatives Overview* in *Understanding Derivatives: Markets and Infrastructure* 9-11 (2013) (OTC markets also exhibit low levels of transparency compared with futures markets Further, OTC markets provide limited price discovery; indeed, OTC trading relies heavily on price information generated by exchange-traded markets.).

book (CLOB) has not been viable for much of the swaps market.² Even relatively standardized swaps are not typically as liquid as futures contracts and historically did not trade via the CLOB as futures do.

The Creation of SEFs

Ultimately, Congress sought a golden mean that would balance these competing concerns. The Dodd-Frank Act gave birth to the concept of swap execution facilities (SEFs). SEFs are platforms on which certain standardized swaps are required to trade.³ They resemble centralized exchanges, but have more flexibility in execution methods to accommodate the unique trading characteristics of swaps. In this regard, Congress took an evolutionary rather than a revolutionary approach, recognizing that mandating too much change too quickly could diminish rather than foster liquidity.

In implementing this portion of the Dodd-Frank Act, the CFTC required swaps that must be executed on a SEF (on-SEF) to trade via the CLOB or a request for quote to at least three SEF participants (Required Execution Methods or Required Methods).⁴ By contrast, swaps voluntarily traded on-SEF may be executed by any method the parties choose.⁵

The SEF regulatory regime has generally worked well.⁶ But rarely is statutory implementation perfect on the first attempt. Some requirements are suitable for the swaps market as a whole but are not a good fit for particular types of transactions. CFTC

² E.g., J. Christopher Giancarlo, Commissioner, CFTC, Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank (2015). CLOBs are the modern computerized exchanges that have replaced the open-outcry trading pits of yesteryear.

³ Specifically, swaps that are required to be centrally cleared must be traded on-SEF unless no SEF makes that swap available to trade. Commodity Exchange Act (CEA) section 2(h)(8), 7 U.S.C. 2(h)(8). The swaps that are required to be cleared are generally the most standardized and liquid classes of swaps.

⁴ 17 CFR 37.9(a).

⁵ *Id.* section 37.9(c).

⁶ See, e.g., Lynn Riggs, et al., CFTC, *Swap Trading after Dodd-Frank: Evidence from Index CDS*, at 6, 52 (Aug. 17, 2019) (finding that SEF-traded index credit default swap markets are working relatively well following the Dodd-Frank swap trading reforms, though there is always room for improvement); Evangelos Benos, Richard Payne & Michalis Vasios, *Centralized Trading, Transparency, and Interest Rate Swap Market Liquidity: Evidence from the Implementation of the Dodd-Frank Act*, Bank of England Staff Working Paper No. 580, at 31 (May 2018) (finding liquidity improvement for swaps subject to the SEF trading mandate).

staff has addressed such issues through a series of no-action letters, many of which have been in place for over six years. With the benefit of this experience, now is the time to begin codifying these no-action letters, with tweaks and refinements where needed.

Through today's action, we continue to strive for the golden mean that strikes the optimal balance between the features of the old bilateral swaps world and those of the anonymous, exchange-traded futures model. In short, we aim to facilitate a natural progression toward more standardized and liquid products with tighter spreads. At the same time, we recognize that certain products that benefit the market do not lend themselves to the Required Execution Methods.

Package Transactions

A "package transaction" typically involves multiple component financial instruments, to be executed simultaneously (or nearly so), with each component transaction contingent on the others. Pricing for certain components of the package is often based on the prices of other components. Some components may hedge other components. Executing these instruments in package form can improve execution pricing and efficiency, reduce execution costs, and mitigate execution risk, as compared with executing each instrument separately (known as "legging" into the transaction).

In layman's terms, a package transaction is conceptually similar to booking a flight and hotel for an overnight trip. Each booking's utility is contingent on the other—making concurrent booking desirable—and there are often opportunities to improve cost and efficiency by bundling the bookings through a travel broker. As a practical matter, the derivatives market is no different.

The final rule approved by the Commission today address package transactions that include both (1) one or more swaps that are required to trade on-SEF pursuant to the Required Execution Methods, and (2) one or more instruments that are not. The Required Execution Methods are suitable for swaps required to trade on-SEF, when such

swaps are executed as standalone transactions. But when these swaps are executed as part of a package, they often take on the trading characteristics of the less-liquid instruments in the package, thereby making it unfeasible to execute these swaps via the Required Methods.

This is a part of the market that is itself evolving.⁷ However, several types of package transactions would include swaps that must trade via the Required Methods under CFTC rules, but currently cannot do so as part of a package. And it is not clear that they will be able to do so in the foreseeable future. Accordingly, today's final rule codifies the no-action relief allowing swap components of those packages to trade through any execution method, provided that the trade occurs on-SEF.⁸ I support this approach because it recognizes the progress made toward centralized exchange-type trading for swaps without forcing the market too far ahead of its natural evolutionary process. In addition, we must work to ensure our rules reflect actual market practice and functioning.

Error Trades

The CFTC, in accordance with the Commodity Exchange Act, has long taken a principles-based regulatory approach to the futures markets.⁹ In granting the CFTC jurisdiction over swaps, the Dodd-Frank Act did not repudiate this principles-based tradition, but instead reinforced it. Section 733 of the Act sets forth core principles for SEFs and expressly affords SEFs "reasonable discretion" in determining how to comply.¹⁰

⁷ CFTC staff has allowed the relief for certain package transactions to expire as swaps markets and market infrastructure have progressed such that the swap component of these package transactions can be executed through the required methods of execution. *See, e.g.*, CFTC No Action Letter (NAL) No. 14-12; NAL No. 14-62; NAL No. 14-121; NAL No. 14-137; NAL No. 15-55; NAL No. 16-76; NAL No. 17-55.

⁸ The final rules would also allow any swap that is part of a package that also includes a new bond issuance to trade off-SEF.

⁹ *E.g.*, Remarks of CFTC Chairman Heath P. Tarbert at the 2019 Annual Robert Glauber Lecture at Harvard University's Institute of Politics (Oct. 24, 2019).

¹⁰ CEA section 5b(f), 7 U.S.C. 7b-3(f) (setting forth core principles for SEFs and providing that a SEF "shall have reasonable discretion in establishing the manner in which [it] complies with the core principles").

In this spirit, the amendments set out a principles-based approach to addressing error trades. They give SEFs the flexibility to determine the most suitable error trade rules for their markets and participants. At the same time, as I have said repeatedly, principles-based regulation is not a euphemism for “deregulation” or a “light-touch” approach.¹¹ Accordingly, under our amendments a SEF must require its participants to inform it of error trades and correcting trades, so the SEF can maintain orderly markets and guard against false error claims.¹²

Conclusion

Today’s action is in keeping with my recent directive on the use of staff letters and guidance, in which I noted that they should supplement rulemakings, rather than themselves function as rules.¹³ CFTC staff has provided important relief over the last six years, but we cannot rely on staff no-action relief to bridge the gaps forever. I expect these amendments will provide certainty and clarity to SEFs and their participants, thereby advancing our strategic objective of enhancing the regulatory experience for market participants at home and abroad.

Furthermore, I remain open to dialogue on further fine-tuning of our SEF rules, consistent with Congress’s mandate as well as the CFTC’s priorities and resources. I therefore will support finalizing additional rules in the near term that have the backing of a broad-based consensus of market participants and stakeholders. Swaps markets will benefit most from evolution, not revolution.

Appendix 3—Supporting Statement of Commissioner Brian Quintenz

¹¹ Tarbert, *supra* note 10; Heath P. Tarbert, *Fintech Regulation Needs More Principles, Not More Rules*, Fortune (Nov. 19, 2019), <https://fortune.com/2019/11/19/bitcoin-blockchain-fintech-regulation-cftc/>.

¹² The final rules reiterate that any SEF offering trading in swaps subject to the post-trade name give-up prohibition must ensure its rules and procedures for error trades allow for error trade remediation without disclosure of the identities of counterparties to one another. *See* Post-Trade Name Give-Up on Swap Execution Facilities, 85 FR 44693, 44701 (July 24, 2020).

¹³ *See* Directive of Chairman Heath P. Tarbert on the Use of Staff Letters and Guidance (Oct. 27, 2020), <https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbetstatement102720>.

I support today's final rule that codifies through rulemaking two issues concerning swap execution facilities (SEFs) currently addressed in staff no-action letters. I am pleased that this final rule will provide market participants with much needed regulatory certainty in the areas of "package transactions" (a series of related transactions sometimes including non-swap components) and the correction of erroneous trades. With the benefit of six-plus years of implementation experience, and multiple extensions of each of these no-action letters, it is long overdue for the Commission to codify and clarify its policy on each of these important issues.

With regard to package transactions, the amendments recognize the need to provide flexible means of execution for swaps that are negotiated and executed concurrently with other components of a larger, integrated transaction. This flexibility has proved workable since 2014.¹ In codifying current permissible practices with regard to the resolution of erroneous trades,² the final rule similarly permits SEFs to allow market participants to execute offsetting or correcting trades through any method of execution offered by the SEF. These amendments will facilitate the prompt identification and correction of error trades, thereby minimizing market participants' exposure to market, credit, and operational risks.

I have long disagreed with the overly restrictive mandate on permissible SEF methods of execution. While Dodd Frank's amendments to the Commodity Exchange Act define a SEF as a trading system facilitating multiple-to-multiple trading activity "through any means of interstate commerce,"³ the CFTC saw fit to only allow for two methods (RFQ and CLOB) to be used in connection with a swap subject to the trade execution requirement ("Required Transactions").⁴ By dictating how Required

¹ These amendments address the relief currently provided by CFTC No-Action Letter 17-55 (Oct. 31, 2017).

² These amendments address the relief currently provided by CFTC No-Action Letters 17-27 (May 30, 2017) and 20-01 (Jan. 8, 2020).

³ Definition of SEF in sec. 1a(50) of the Commodity Exchange Act.

⁴ Reg. 37.9(a).

Transactions are executed, the current regime forecloses any number of alternatives that could create liquidity on SEFs and better address the highly variable, bespoke nature of many swaps. I believe the Commission should follow the law and further expand the allowed methods of execution for Required Transactions to any form that is truly multiple-to-multiple, which would allow SEFs to experiment with new means of execution tailored to the bespoke liquidity of a wide variety of critical risk management products. Similarly, in the area of block trades, I recently expressed concern when the Commission raised the block size threshold, thereby reducing the population of swaps that can be negotiated through alternative means.⁵

Lastly, I hope the Commission promptly finalizes additional provisions of the SEF ruleset that the Commission has proposed revising. These areas include making more practical the SEF financial resources requirement and codifying an exemption from the trade execution requirement for swaps between affiliated counterparties. Resolving these issues through final rules will promote the liquidity and transparency of SEFs.

Appendix 4—Statement of Commissioner Dan M. Berkovitz

I support today's final rule to amend parts 36 and 37 of the Commission's regulations relating to the execution of package transactions and correction of error trades on swap execution facilities ("SEFs"). The final rule will further, in a flexible and cost-effective manner, the Congressional goal of promoting the trading of swaps on SEFs.

Beginning in 2014, the Commission issued a series of no-action letters specifying permissible methods of execution for certain package transactions, which enabled the agency to phase-in the application of the trade execution mandate for these transactions. As market infrastructure has evolved, the Commission has allowed portions of the relief for some package transactions to expire, leaving a narrow set of these transactions that

⁵ Supporting Statement of Commissioner Brian Quintenz Regarding Final Rules Amending the Real-Time Reporting Requirements, available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement091720b>

still may be implemented through flexible methods of execution. Based on experience, the Commission has determined that flexible methods of execution are currently more appropriate for packages in which at least one of the components is (1) a swap not subject to the clearing requirement; (2) not a swap; or (3) a swap for which the CFTC does not have exclusive jurisdiction. Requiring that the swap components of these transactions be traded through the required methods of execution (i.e., Order Book or Request-for-Quote to a minimum of 3 counterparties) could force market participants to break up the package into their individual components, which would increase transaction costs and risks, and thereby defeat the economic purpose and efficiency of the package transaction. Commenters supported the rule as proposed. It is therefore appropriate for the Commission to codify that flexible methods of execution may be used for the swap components of this limited set of package transactions.

The final rule also exempts from the trade execution requirement swap transactions that are components of “new issuance bond” package transactions, and amends part 37 to provide flexibility in the execution methods a SEF may offer counterparties to correct clerical or operational errors. While providing additional flexibility for resolving error trades, the rule limits the number of instances in which such errors may be corrected, and preserves important protections to guard against abuse. Notably, the Commission requires market participants to provide prompt notice to a SEF of an error trade, enabling the SEF to conduct real-time market monitoring and fulfill other self-regulatory obligations. In addition, the rule makes clear that a SEF must maintain rules and procedures that are fair, transparent, incentivize timely resolution of an error trade, and allow for such resolution without disclosing the identity of counterparties to one another where the swaps trading is subject to the post-trade name give up prohibition.

Given the tailored nature of these amendments and the appropriate safeguards, I support this final rule. I thank the staff of the Division of Market Oversight for their work on this rule and their helpful engagement with my office.

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